



Economic Affairs / *A Monthly Analysis*

A special supplement to CHALLENGE

May 1, 1961

TOUCHING BOTTOM? The current flow of economic statistics supports the belief that the downswing is ending. A new phase of the business cycle is about to begin. The hopeful signs are found in the "leading indicators" of the National Bureau of Economic Research. NBER, a distinguished nonprofit research group, has 12 statistical series that generally turn before the economy turns.

Of these 12, 9 have turned up. Two still look bad. One appears to be approaching its turning point.

The 9 reassuring indicators are: (1) stock prices; (2) declining dollar liabilities of business failures; (3) raw materials prices; (4) industrial and commercial building contracts; (5) new orders for durables; (6) hiring rate; (7) declining lay-off rate; (8) average workweek; (9) residential housing starts.

Business inventories are still declining, but at a declining rate. Corporate after-tax profits and the number of operating businesses are falling off.

WHAT KIND OF AN UPTURN WILL IT BE? At first glance, it does not look as if it is going to be a brisk one. True, retail sales are up. But consumers are still hesitant, according to the latest survey taken by Michigan University's Survey Research Center. And business spending plans for new capital equipment—the most important possible source of power for an upward push—are 3% below last year's.

The government intends to continue its red ink policy as we go into the upturn. But it plans a smaller deficit than the \$12 billion of the last recession. The federal deficit for the year ending June 30 will be \$2.2 billion. Next year's budget calls for another \$2.8 billion deficit. This isn't a massive dose, but its effect will be felt on output and employment. And on prices.

On the monetary side, the Federal Reserve seems willing to continue its easy money policy for at least a little way into the upturn. The Fed is engaged in a tricky maneuver to keep short-term interest rates from falling too far, so as to keep money from flowing to Europe, while holding long-term rates down. This maneuver has not been an unqualified success and will become more difficult to carry off as the recovery develops. At that time, while the government is still borrowing, business will increase its demands on the money market for funds and the 2 forces will bid up the price of money.

A relatively high rate of unemployment will continue to plague the economy for some time. Cyclical unemployment tends to lag behind any recovery and, although our problems of structural unemployment will be aided by the upturn, they will not be solved by it.

In terms of the decline of industrial production, this has been the mildest of the postwar recessions. Judging from past experience, it should take the economy about 6 months to return to its former output peak once the corner has actually been turned.

SPECIAL CORRESPONDENCE—There is growing concern in Washington over the feverish activity in Wall Street. Although it is probably too late in this Congressional session to start an investigation, the tremendous surge in trading activity is being watched with growing concern. Days in which 6 million and 7 million shares are traded on the New York Stock Exchange have become commonplace.

The heart of the problem, however, is not the stock exchanges. It is the sharply rising activity in so-called over-the-counter markets where rules and regulations are not as stringent as on the principal exchanges. Evidence of sharp practices in this area would bring pressure for more SEC power to step in.

President Kennedy is having increasing difficulty with organized labor whose leaders were among his strongest supporters in last fall's campaign. He has put these labor leaders in a difficult position by declaring war on 2 of the AFL-CIO's main objectives: a shorter workweek and more pay increases.

The President has made it perfectly clear that the drive for a shorter workweek threatens one of his principal economic goals: an increased rate of growth. He is also on record as opposing another wage-price spiral—particularly in basic industries. Another such spiral would not only fuel the inflationary engine but would further aggravate our balance of payments position by making many U. S. products even less competitive than they are already.

The Soviet Union's economic offensive in the underdeveloped countries continues to make substantial progress despite Moscow's frequent failures to keep its promises. One of the reasons for this success is the Kremlin's discovery of a convenient substitute for the normal—and more expensive—kinds of economic aid.

The Russians are now delivering vast amounts of slightly out-of-date conventional armaments to these emerging nations. This involves practically no sacrifice for the Soviet Union which is rapidly re-equipping its forces with the most up-to-date weapons. The orders for this hardware are met rapidly and at knockdown prices. Most of the nations seeking this equipment are indifferent to the cold war but are anxious to exert influence over their neighbors who have also just emerged from colonial status.

Despite its increasingly radical public tone, the Algerian nationalist movement is reconciled to maintaining most of its present economic links to France once independence becomes a reality. Without them Algeria would collapse. Last year 81% of Algerian exports went to France and 84% of its imports came from there. In addition, over 250,000 Algerians work in France. Employment could never be found for them in Algeria and their remittances home are a valuable contribution to the Algerian economy.

The United Nations Economic Commission for Asia and the Far East is studying the possibility of regional economic groupings for that area patterned after the European Common Market. Two such groupings are now under consideration. One would encompass the Philippines, Malaya and Thailand, while the other would involve Burma, Laos, Cambodia, South Viet Nam and Singapore.

Japan's economic problems will dominate the talks between Japanese Prime Minister Ikeda and President Kennedy when Ikeda comes to Washington in June.

The problem of trade with Red China heads the list. Ikeda is under strong pressure from his Socialist opposition to step up trade with Peiping and he wants to find out how far he can go without bringing on an open break with Washington. As a consequence, Kennedy may attempt to ease U. S. barriers against Japanese goods.



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Challenge

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THOUGHTS IN ORBIT

IT IS HAND-WRINGING TIME in the United States again. The Soviet man-in-space, like Sputnik I, has opened the floodgates to a rush of desperate commentary on what is wrong with this country.

No doubt about it. The omelet hit the fan once Yuri Gagarin's feat had been verified. Our reactions were full of injured pride—in some cases glossed over by a show of good-sportsmanship, in others sparked by downright anger, and in still others expressed as a "so what," sour grapes attitude. Not symbolic, I hope, was the reaction of our own astronauts' press relations officer. Upon being awakened during the early morning hours by eager reporters, he managed to utter these illuminating words: "We are all asleep here."

During the more decent hours of that same day, and for several days thereafter, this is what happened in the United States of America:

- Children all over the land plaintively asked their parents why "we didn't do it first."
- The space program people were beleaguered by questions about how long it would be before we could "catch up and surpass the Russians."
- Some patriotic politicians demanded an investigation to "look into the mess."
- Some members of Congress were ready to vote "whatever money could buy."

Amidst the general din, however, the majority of the populace managed to stay with their income tax returns, practicing a national artistry calculated to render the individual inconspicuous before the chilling glance of the internal revenue auditor.

It took three years after Sputnik I to bring the Russians down to size—to convince our public opinion molders that we weren't about to be outstripped in everything. Now, with Gagarin in orbit and back again, the Russians are once more 10 feet tall. What happens to the American sense of proportion on these occasions of Russian scientific triumph? Can't we witness an achievement by someone else without getting into a nervous sweat about it? Are we that unsure of ourselves?

Now, hard on the heels of Russia's space triumph, comes news of a U.S. government study comparing investment patterns in the U.S.S.R. and the U.S.A. Read in the context of dismay engendered by Russian scientific and technological progress, this report holds further discouraging news. But viewed in the cold light of reason, there is little in the report to fret about.

For example, the latest statistics show that in 1959 the Soviet investment in agriculture was \$10.1 billion,

while in the U.S. it was only \$4.8 billion. The Soviets have surpassed us? Hardly. They have a crisis in agriculture—chronic *shortages* in meats and dairies, and periodic shortages in grains of all types. They need all the investment in agriculture they can manage. We are being swamped by agricultural *surpluses*—and the cost of supporting the prices of these surpluses.

Another example: Soviet industrial investment in 1959 stood at \$29.9 billion, whereas the American counterpart was \$17.6 billion. Again the figures seem to have turned against us, but their meaning is not so uncomplimentary to the American effort. In the first place, 1959 was a "depressed" year for industrial investment in the U.S.A. In the second place, with much of American industry already standing with greater capacity than market demand, there seems little reason to desire large industrial investments at this time. And in the third place, in a Russian economy that is relatively underdeveloped when compared with the U.S. economy, one should expect large industrial "catch-up" investments.

Still another example: total new investment in the U.S.A. in 1959 stood at \$71.3 billion; and in the Soviet Union at \$63.6 billion, with the prospect that by 1965 total new investment would be the same in both countries. Are these the signs of being overtaken? Not yet. In housing, transportation and communication, new investments in the U.S.A. are still twice as heavy as in the U.S.S.R. Highways, shopping centers and the components of a consumer-oriented economy figure heavily in the U.S. scheme. Not so in the Soviet Union.

... and back to earth again

All this is not to say that we have nothing to worry about, or even little cause for alarm. The fact is that we are faced with a dynamic, growing competitor—one who one day may be producing more milk, butter and steel than we can use. But I doubt that we can prove the superiority of our system by beating them to the moon, any more than they have proved anything *conclusive* by their latest "first."

The simple truth is that we are each competing to maintain, above all, a sense of physical security—whatever that means in a nuclear age where devastation delivered from a jet bomber is no less total than from a space platform. In the military sense, the race is a Mexican standoff, unless one or the other falls so hopelessly behind that victory can be had by default. This kind of lapse by either side is most unlikely.

The real competition, in the last analysis, is for the hearts and minds of the almost three billion people of the world. Which system can bring the highest satisfaction to the most people? *Survival for what?* is an old question. An inspired answer from the United States would win more mileage than any space feat could possibly achieve.—H. B.

LETTERS TO THE EDITOR

CHALLENGE invites your comments. Address letters to CHALLENGE, 475 Fifth Avenue, New York 17, N. Y.

THE FARM PROBLEM

• The March issue of CHALLENGE was a keen disappointment to me. Nowhere did you have any consideration of how the farm problem fits into our national economic predicament. This failure to recognize the importance of agriculture in the nation's economy is the real reason we are at another crossroads.

The farmer is \$10 billion per year off in gross income. He spends both his gross and his net. But no one has even conjectured on how much unemployment has been caused by the fact that the farmer has been forced out of the market to this extent.

CARL PORTZ

Newcomerstown, Ohio

► We invite Reader Portz' attention to our July issue when we shall run an article on the Kennedy Administration's farm program.—Ed.

UNEMPLOYMENT AND INFLATION

• I would like to take issue with Prof. Chamberlain ("The Many Faces of Unemployment," March, 1961) concerning his reasoning that there is no basic incompatibility between approaches to full employment and control of inflation. He reasons that the increased production of full employment would act as a brake on inflation. He fails to recognize the whole modern theory of investment as I see it. He wants to arrive at his destination without taking the hazardous journey.

I am amazed that he could write such a long article on unemployment without mentioning the role of investment. Risk capital is the creator of all jobs, and, with automation accelerating, the amount of capital required per job is rapidly increasing. With the very high taxes on investment return, the stimulant for such investment is lacking, unless there is a high inflationary factor. The fact is that people of means do not invest for the small return after taxes. They invest to avoid gradual confiscation of capital via inflation.

Unless traditional investment incentives are restored, we are doomed to unemployment and inflation, and they will be in inverse proportion to each other. We have already witnessed two inflationary recessions and rising unemployment at a time when the

work force is growing more slowly than the population. When the population bulge reaches the age of employment, the unemployment and inflation crisis will deepen. Capitalism has reached a point where it must run faster just to stand still. Since I doubt that the tax grabbers will let up, I predict an accelerated inflation that will result in widespread government controls, that will be the death of freedom and enterprise.

How simple it would be for the government to let the goose incubate his golden eggs instead of stealing them from the nest.

CHARLES LAGMAN

Birmingham, Ala.

ALL BOOKS BEST SELLERS?

• Books, according to your March issue, are no longer merely literature but big business. With this good news, book sales receipts may overtake television repair bills and even threaten cosmetics as a proportion of the gross national product. Perhaps they may do for prosperity in the Sixties what automobiles did in the Twenties.

Motivational researchers will soon be able to tell publishers what books will sell and authors what books to write. Special tests given in school will steer the right boys and girls to a lucrative career in literature. An author's earning power over his lifetime might even be capitalized and shares sold over-the-counter or, for those with special appeal, on Wall Street. No longer will authors waste their lives writing or publishers waste their money bringing out books that *don't* sell.

Those of us who like books that don't sell can always order them from Europe or write them ourselves. Perhaps 10 years from now an issue of CHALLENGE may have an article entitled "Are Books That Don't Sell Coming Back?" I sincerely hope so.

DANIEL G. HARWELL

San Francisco, Calif.

HEALTH AND HUMAN RIGHTS

• In "Needs of the Aged" (March, 1961), Mr. Essig seems inordinately worried that, under a social security approach, old age medical assistance will benefit some people who are able

to pay their own medical expenses.

"The aged do not form a homogeneous group," says Mr. Essig. Their needs "vary tremendously according to their situation." Does Mr. Essig feel, then, that all of our young people do not have the right to a free education since "their needs vary according to their situation"? Does he feel that parents who can afford a private education for their children should be obliged to pay for it?

It seems to me an anomaly that in an advanced Western society, which treasures freedom and the good things of life, education should be regarded as a basic "right" of all men while good health is not. The U.S. is practically alone among the industrialized countries of the West to hold to this curious standard. Is there another advanced country in the Western world today that does not have some state-supported health plan?

I wonder how much of a comfort it is to an elderly person stricken with serious illness to know that "medical expenses amounted to only nine per cent of a sample budget for elderly couples compiled by the Bureau of Labor Statistics." I wonder if he takes much pride in his self-reliance as he sees his possessions and his income, the products of a lifetime of struggle, swept away in order that he might have the "privilege" of living as free from pain as possible.

PETER SIKES

Bronx, N.Y.

DOCTORING THE ECONOMY

• Your editor says that the "doctor" of free enterprise is still the best one around and that what he really needs is a better bedside manner (March, 1961). In view of the persistent belly-aches that are plaguing our economy—e.g., inflation, flagrant violations of the antitrust laws, recession, depressed areas—I think the doctor would do better to forget about bedside manners and go back to medical school for a refresher course in how to deal with economic ills.

LEE WALKER

Chicago, Ill.

APPRECIATION

• I have been much impressed with the copies of CHALLENGE I have read. I am currently the economics teacher at Mount Herman School. I find your articles a big help in my attempt to relate economic theory to actual practice in situations today.

DALE CONLY

Mount Herman, Mass.

NEW WINE FOR OLD BOTTLES?

by NORMAN B. TURE

■ THE ADMINISTRATION's bill to aid depressed areas seems to be on the point of receiving Congressional approval as this is written. The legislation is designed to provide \$394 million in federal loans and grants to communities suffering from chronic unemployment. Will this measure be a cure, or merely a palliative for depressed areas?

The aid afforded by this legislation will be available only to the most severely depressed areas. To qualify, a community must be suffering from "substantial and persistent" unemployment. This provision made 20 major industrial centers and 88 other areas eligible. In February, 1961, however, an additional 81 major centers and 96 other areas suffered from the melancholy distinction of having more than six per cent of the labor force unemployed, although this condition had lasted for a shorter period of time than it had for communities designated as depressed areas.

To the communities that qualify for aid, the bill will provide financial assistance for the creation of new job opportunities. Federal loans will be available for private projects approved by an agency of a state or a subdivision of a state. The loans can be employed to purchase or develop land or facilities—even including, in exceptional cases, machinery and equipment—for industrial and commercial usage, and for the construction and improvement of plants.

The bill provides loans and grants for public facilities needed for such development. Aid will also be given for vocational retraining and for subsistence payments during retraining. Depressed rural areas can be designated as "redevelopment areas." Financial aid will then be available to establish factories or resort facilities. In all cases, an area must draw

up a comprehensive and viable plan for redevelopment.

Will this program do the job?

High levels of unemployment are not confined to the depressed areas. These areas suffer, in an accentuated form, from a malady that affects the nation as a whole. In March, 1961, 5.6 million people were out of work; the seasonally adjusted rate of unemployment of the civilian labor force was 6.9 per cent. There is no doubt that the major cause of this distressing state of affairs is the current recession, coming on top of the weak recovery from the recession of 1957-58.

Inadequate demand

Fundamentally, this problem stems from an inadequate level of total demand—the failure of total spending by consumers, business and government to live up to our expanding productive capacity. As reflected in seasonally adjusted unemployment rates, this condition has prevailed without interruption since the third quarter of 1957. Unemployment has averaged five per cent or more in every quarter since that time.

Obviously, however, the depressed areas are worse off than the rest of the nation. Indeed, in very general terms, a depressed area can be defined as one in which, for a prolonged period of time, a substantial portion of productive capacity—labor, plant and equipment—has been idle or in which income levels and, hence, productivity have remained substantially below the national average.

This definition includes major industrial centers—for example, Detroit, Pittsburgh and Providence-Pawtucket. It also covers many smaller industrial towns and a number of

rural regions. In the early postwar years rural regions of low income, many of them in the Appalachians, made up a larger proportion of the depressed areas than at present. Today depressed areas cover a very large part of the map between Maine and northeastern Texas, and include a large number of urban industrial communities. Another major concentration, primarily of depressed industrial centers, has grown up in the Great Lakes region. A third concentration is located in the Northwest. A fourth extensive area consists of the western half of New Mexico.

In the vast rural depressed areas, grinding, persistent poverty has affected the people's health, educational standards, morale and spirit. These costs are difficult to measure. To appreciate them, one must see the dilapidated and decaying towns of West Virginia, or the poor farms which form a dirty patchwork on the hillsides of the Appalachian range. An attempt to state the costs of rural depression in quantitative terms, however, was made recently by Secretary of Agriculture Freeman before the Production and Stabilization Subcommittee of the Senate Banking and Currency Committee in its hearings on depressed areas legislation.

He discussed the problem of rural "underemployment"—people who put in full time working, who are willing and able to use their opportunities, but whose productive capacity, nevertheless, is not fully utilized. He estimated such agricultural underemployment was the equivalent of 1,400,000 man-years of unemployment per year. The reflection of this underemployment in income levels is equally disturbing. In 1959, the Secretary reported, 36 per cent of

farm families had incomes less than \$2,000; for the nation as a whole the proportion was 13 per cent. Moreover, 646,000 rural farm families—17 per cent of all farm families—had money incomes of less than \$1,000 per year from all sources.

Depressed areas are created by a number of factors and show highly varying characteristics. Let us first consider the major groups of depressed industrial centers that are primarily oriented to the automobile and steel industries. Few of us are prepared to regard American automobile manufacturing as a declining industry. Nevertheless, the industry has not operated at or near capacity since the model year 1955.

Moreover, the boom sales of 1955 inspired an investment program that resulted in a substantial reduction in man-hours required per unit of output. As output has been less than capacity for several years, the major automotive producing centers have developed large pools of unemployment.

Much the same is the case for the nation's steel producing centers. Here, too, is an industry operating at rates leaving an ever-widening gap between capacity and output. At the same time, methods of production have been changing. Increasing

plexes in the older centers such as Detroit and Pittsburgh. As a result of these changes in location, pools of unemployment have developed in the older producing centers.

Four intermingling factors are at work in the cases cited. They are: the inadequacy of the rate of growth of total demand, changes in methods of production, movement of production centers and rapid shifts in the composition of demand.

Auto industry

Let us investigate the inadequacy of the growth of total demand as it relates to the auto industry. In every year since 1955, except 1958, per capita disposable income (income after taxes), measured in constant dollars, has risen; but the rate of growth during this period has been less than for the period between 1947 and 1953. Had it risen at two and one-fourth per cent a year—a rate slightly less than the 1947-53 average—per capita disposable income would have been about three and one-third per cent higher in 1960 than it was in fact. This would have added \$12 billion to total disposable personal income.

Such a higher figure would not necessarily have meant an increase in auto sales sufficient to wipe out un-

communities like these would have remained.

The second source of depression illustrated in the case of the old automobile and steel centers is the change in methods of production; this technological advance results in the displacement of production workers by machines.

In a very important sense, this problem cannot be appraised except in the context of the demand for the products involved. For the economy as a whole, we expect that productivity will advance by about two per cent per year. If aggregate demand were to remain constant while these productivity advances occurred, it is clear that a rapidly rising level of unemployment would result. Indeed, if unemployment is not to increase, total demand will have to rise by enough to allow for the increase in the labor force, as well as for the increase in productivity. Much the same may be said of the specific industries whose changes in production techniques are associated with depressed areas. If demand for the products of these industries fails to expand rapidly enough to allow for the increase in productivity, rising unemployment will result.

Technological advance gives us the opportunity for a richer life, but we may have to make some strenuous adjustments to take advantage of it. Since these advances make it possible to reduce the unit costs of production, they are clearly desirable in any event. But if our demand for a commodity does not increase in line with our capabilities to produce it, we must be prepared to find other worthwhile uses for the resources—including labor—no longer required in this production. The more the change in technology outpaces the increase in our demands, the more serious will be the problem of assuring employment opportunities for the resources that have been freed.

A third source of depression is the movement of production centers. Textiles are a more impressive and more familiar instance than the auto and steel industries. The wholesale removal of textile manufacturing from New England to the South transformed the nation's oldest manufacturing center into an industrial wasteland. The older auto and steel



amounts of steel can be produced with fewer man-hours of effort by production workers.

Both steel and autos illustrate another source of the problem of depressed areas. In each case, the industry has been decentralizing for some years past. New production facilities have been put up in an increasing number of localities rather than added to the industrial com-

plexes in the older producing centers. But the problem would have been considerably alleviated. Moreover, if the rate of growth had been greater than two and one-fourth per cent—something the economy has shown that it can achieve—the problem of depression in these areas would have been even less. But even with an adequate growth of total demand, some part of the problem of

production centers have seen the same kind of movement occur in more recent times.

On the whole, this mobility of capital is a wholesome aspect of the nation's economic life. Considering the magnitude of the costs involved when a company relocates, it is clear that the new site must have substantial advantages over the older one. These advantages may stem from labor conditions, transportation facilities, fuel sources, raw materials, financing costs or perhaps even a host of intangible factors.

Of course, the management of the company making such a move may be wrong. Nevertheless, industrial relocation has been so widespread in recent years that we must conclude

The depleted—but not exhausted—mines can no longer be profitably operated. The human resources they once employed must shift to other occupations or remain idle.

Changes in the nation's defense program are another source of industrial depression. The air frame manufacturing industry, for example, was until quite recently a major contributor to defense production. The shift in emphasis to missiles has imposed on the companies involved the need for rapid diversification of their operations if they are not to become another declining industry.

The depressed rural areas represent a different state of affairs from that found in depressed industrial communities. The focus of this prob-

pression in these rural areas is lack of capital. For many years both private and public investment in tangible and intangible forms has been inadequate to provide the gains in productivity needed to keep pace with the rest of the national economy. As a result, these areas have educational standards and levels of educational achievement significantly below the national average. Their highway and railroad systems are inadequate. They have failed to exploit their waterways and forest lands effectively. Their submarginal farms do not show the amazing technological progress in agriculture to be seen elsewhere in the country.

Common characteristic

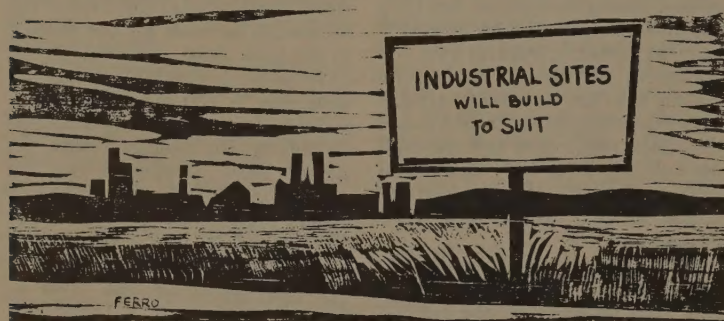
To sum up, our examination of the various factors contributing to the problem of depressed areas suggests that there is no one simple solution. All of the depressed areas, however, have one common characteristic—a relatively high degree of immobility of the people who are unemployed or underemployed. Reducing this immobility is not an easy undertaking, but, in all likelihood, it is essential if the depressed area problem is to be overcome.

The barriers to greater mobility of labor can be grouped into two major categories.

In the first category there are (1) lack of the financial resources required to move one's family to a new location, to find suitable housing and to meet living costs until new employment can be found; (2) lack of skills for a different job; (3) lack of knowledge about job opportunities in other lines of work and in other parts of the country; and (4) the possible loss of furlough, unemployment benefits and pension rights.

In the second category are all the nonpecuniary considerations attaching a family to a location, even in the face of dwindling economic opportunities. This type of barrier to labor mobility may be the most difficult to contend with, although experience during World War II showed that when the financial rewards are great enough, these non-economic deterrents to mobility can be overcome.

A first step, then, would be to enlarge the activities and responsibili-



that most of these movements have been in response to significant and real differences in costs. Moreover, we must also conclude that such movements have been in the best interests of the economy as a whole, even though in specific instances they have left behind large numbers of unemployed men, empty factories and idle machines.

A fourth factor in the creation of depressed areas is the rapid and drastic shift in the composition of demand which is so characteristic of our dynamic economy. Such shifts are the counterpart of changes in production techniques and are an aspect of economic progress. Its by-product, unfortunately, is often declining industries and depression in the areas where the displaced industries once flourished.

The coal-mining regions of West Virginia grimly illustrate this source of depression. Oil, gas and electricity have taken over many of the chores which used to be performed by coal.

lem is not in localities but in extended geographical regions. These areas do, indeed, contain cities, towns and villages with persistently high rates of unemployment. But the full extent of the problem of depressed rural areas is measured not in terms of the number of unemployed but in the extent of underemployment.

Fundamental source

Moreover, the major factors which have produced depression in industrial communities—shifts in demand, technological changes, the movement of industry, and business cycle swings—have not been the primary determinants of rural depression. Low-income rural areas have shown a distressing insulation against general economic trends ever since the end of World War II. Indeed, their lowly place on the nation's economic ladder considerably antedates the war.

The fundamental source of de-

ties of the state employment services. They should provide information about job opportunities not only in the locality in which the jobless are seeking employment but in a much larger region. These agencies should be empowered to provide financial assistance to those relocating and retraining. They should, moreover, facilitate the social adjustments that families must make when relocating.

It is unlikely that the states can or would undertake such a program without assistance from the federal government. The question of how to provide greater federal aid without removing primary responsibility from the states should be a major concern of any federal program for area redevelopment.

The task force on depressed areas headed by Sen. Douglas proposed another measure. Its report to President Kennedy spoke of "some regions in the country where economic problems are particularly deep-seated and severe." Citing such regions as the Appalachian area, and the New England and upper New York textile area, the report urged "a program of regional development commissions to attack the special problems of each region and to propose means for formulating and carrying out comprehensive development programs."

As an immediate step, it recommended "that the President appoint such a commission for at least one of these major areas." The Appalachian area, because of the size and severity of its problems, was suggested as the first candidate. It could, in turn, "serve as a possible pilot project for similar efforts in other regions."

These proposals are not included in the current legislation. However, the loans and grants the new law will make available can be expected to act as catalysts for the revival of business activity in depressed areas. The legislation will be most effective in marginal and declining areas that need only relatively modest help to make an economic comeback. But unless we are prepared to disregard the major factors causing areas to be depressed, the legislation should be thought of only as a beginning.

Modifies impact

The assistance to be granted to localities cannot, of itself, increase total demand to a full employment level. All it can do is to modify somewhat the impact of shifts in demand, of technological changes and of migration of industry. Indeed, it should not aim to do more.

In fact, those opposed to this leg-

islation fear that the subsidies it provides would tend to obscure sound business judgment in the selection of plant sites. The result, they say, will be some alleviation of depression in the areas receiving federal aid at the cost of misallocation of resources and lower productivity than otherwise would be attained in a much larger area of the economy.

Basic to any solution of the depressed area problem is providing and maintaining a full employment level for the economy as a whole. As we have seen, this condition will not itself eliminate the pockets of depression in industrial centers nor raise the productivity and income levels of depressed rural areas. It is, however, a necessary condition if other more concentrated efforts are to succeed. There is little sense in increasing the job mobility of the unemployed or underemployed if work opportunities as a whole are inadequate to meet the expansion of the labor force and its growing productivity. Nor should we wish to subsidize the movement of industry into today's depressed areas if the cost is to be the creation of new ones. The attack on depressed areas, therefore, should employ general fiscal and monetary measures as well as whatever specialized devices may be developed. ■

Greater New York — a nondepressed area

A Lesson in Diversity

by ROY B. HELFGOTT



■ AT THE BEGINNING of the year, 76 out of the 150 leading production centers in the United States had unemployment rates of more than six per cent. They were, therefore, areas of "substantial labor surplus," according to the Department of Labor. Among them were Detroit, Philadelphia, Pittsburgh, Cleveland, Los Angeles and St. Louis—but not New

York. Why is New York less vulnerable to unemployment than other important centers?

The answer lies in the great diversification of business and industry, and in the high proportion of service jobs there. New York is America's business headquarters, cultural center, largest industrial center and—by virtue of the presence of the United

Nations—the "capitol" of the world. The economic unit that is New York today covers 7,000 square miles, and is made up of New York City and a ring of localities around it stretching into New Jersey and Connecticut. This New York, though not growing as rapidly as some other areas, is still by far the largest metropolitan region in the nation, and no

other will come close to it in size or importance in the foreseeable future.

Six out of 10 Americans today live in metropolitan areas. The New York metropolitan area alone has 16 million people—close to one-tenth of the nation. During the past few years the region was the subject of intensive economic analysis by the New York Metropolitan Region Study, undertaken by the Harvard University Graduate School of Public Administration. The study has culminated in a series of books, which shed light on the existing pattern of industries, jobs and workers in New York and their future prospects.

Diverse occupations

Within the metropolitan region, close to seven million people work at the most diverse occupations in a wide assortment of industries. Population is equally divided between New York City and the surrounding ring of counties, but 40 per cent of the jobs are concentrated in the city, and more than one-third of the seven million jobholders work within the 10 square miles that comprise Manhattan's central business district.

Of the seven million jobs, two million are in manufacturing, three-quarters of a million in retail trade, and from a quarter to half a million each in wholesale trade, finance and real estate, business services, public utilities, personal and mixed services, and construction.

New York's economy is marked by a high concentration of business service establishments, financial institutions and wholesaling units, many of which service clients and customers throughout the nation. The manufacturing sector is also distinguished by its diversity: New York has more manufacturing industries than any other metropolitan area, and almost every type of industry is represented in the region.

Diversity of industry begets diversity in the labor force. New Yorkers work as actors, barbers, diplomats, educators, fishermen, lathe operators, masons, neurologists, presidents of large corporations, radio and television technicians, sewing machine operators, typesetters, union officials, writers and at thousands of other jobs.

New York has become the front office of American business, and more

than one out of every four members of the labor force is part of the white-collar corps. Some 300,000 work for banks, insurance companies and other financial institutions. Fully 130,000 of them work in "Wall Street," the cluster of banks, brokerage houses, and stock and commodity exchanges located below Chambers Street in lower Manhattan.

Another 900,000 work in the central offices of the nation's large corporations, business service establishment offices (accounting, law, advertising, engineering), real estate offices, and public utility, government and miscellaneous offices. In addition, there are 685,000 clerks, typists and bookkeepers on the premises of manufacturing, retail, transportation and other establishments.

Not only is New York a great office center, but it is also the nation's largest industrial center. The leading manufacturing industry is wearing apparel, and one out of every three jobs held in the U.S. garment industry is located in the metropolitan area. In second place is the miscellaneous manufacturing category, covering such industries as jewelry, toys, costume jewelry, plastic items and office supplies. One out of every four jobs in these industries is in the metropolitan region. In third place is printing and publishing, in which the metropolitan area accounts for one out of every five jobs.

While the apparel industry employs 23 per cent of New York's manufacturing workers, the region is not as heavily dependent upon it as Detroit is on automobiles or Pitts-

burgh on steel. New York's half-million garment and textile jobs, for instance, are more than balanced by the number in the metals and machinery industries. The manufacture and processing of food products provides jobs for another 150,000 workers, and if the number of people employed in the retail distribution of food, and in eating and drinking places is added, a total of half a million New Yorkers are found to be engaged in feeding the rest of the region's populace.

The metropolitan area's manufacturing is also distinguished by the relative importance of consumer goods industries selling their products to the national market. Fully 40 per cent of its manufacturing is in the consumer goods category; this is the highest proportion in any major metropolitan area with the exception of the automobile center in Detroit. The consumer goods sector is largely composed of small, one-plant firms employing less than 50 workers each, and specializing in the production of light consumer articles—every type of apparel, toys, jewelry, sporting goods, pens and pencils. Many of these industries, particularly apparel, employ mainly women as production workers.

Light consumer goods

The diversity of the metropolitan region's manufacturing and the high proportion of light consumer goods industries make New York less vulnerable to the swings of the business cycle. When the nation's economy turns downward, heavy goods industries are the first and hardest hit, because business cuts back on purchases of new machinery, and consumers can more easily postpone buying new cars and refrigerators than food and clothing. New York, therefore, does not suffer the severe contractions of economic activity that Pittsburgh and Detroit experience during recessions. The city is even more insulated against boom and bust than the suburbs, since the durable goods factories are concentrated in the outskirts of the metropolitan region.

The island of Manhattan itself is a great manufacturing center, providing about half a million jobs. It is the concentration point of light consumer goods manufacturing, particu-



larly apparel; 100,000 workers are crowded into the midtown Garment Center alone. Manhattan's manufacturing, however, is declining as a result of the movement to the suburbs, a trend common to all the nation's major cities.

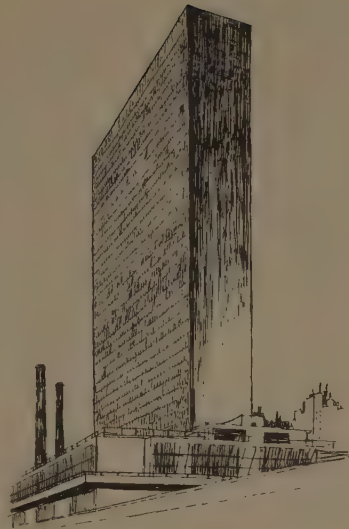
A major explanation of the outward migration of manufacturing is the character of the older, built-up areas. Manufacturing today requires long, one-story structures with more space per worker, thus rendering old factory buildings obsolete. A combination of zoning problems, the lack of available large tracts and the high cost of sites in the city drives firms to erect new plants outside the center of the region. Furthermore, as people move to the suburbs, many types of businesses, such as food processors and retail stores, try to get closer to their customers.

Other factors have driven some industries to seek suburban locations. A trek of garment shops to suburbs began as early as the 1920s because of the feasibility of separating the sewing and pressing from the designing and merchandising, the rise of the motor truck and lower wages outside the city. Now the new shops are springing up well beyond the outermost borders of the region, because the growth of higher paying manufacturing industries in the suburbs and the substantial unionization of those plants has tended to equalize wages between the city and its environs.

However, most of the jobs in New York are impervious to the lure of other areas, at least as far as wages and skills are concerned. Three out of every five jobs are in trades that serve the local market—retail stores, personal services, banks, transportation facilities, public utilities, breweries, bakeries, newspapers, construction and the like.

"External economies"

Still other jobs are tied to the region in other ways. There may be a need for quick delivery or for personal contact (as between publisher and author). The cost of communication may enter the picture. Or there may be "external economies"—the existence of specialized firms which provide services to many small producers. Examples are the embroidery houses that service garment



manufacturers, and the commercial artists and printers that service advertising agencies. Yet another factor tying jobs to the region is the uncertainty of many businesses, which must be able to hire additional workers on short notice.

Even activities sensitive to the cost of labor are unlikely to desert New York when they are dependent upon pools of skilled labor. Interregional differences in the wages of skilled workers are much narrower than those for unskilled, and such skilled workers are often easier to find in New York than elsewhere. Thus, the production of special-purpose machinery, of high-style consumer goods and the operation of research agencies are likely to remain concentrated there.

The cheap lines of such products as apparel, printing, greeting cards, medical supplies, building materials and textiles, which are more standardized and whose volume is great, are most subject to interregional competition. These products are made by less skilled workers and are highly competitive with respect to price. Labor costs comprise a significant part of their total costs of production and, for the most part, they have low transport costs. Thus, interregional competition with regard to these products is based on tapping sources of cheap labor supply.

Of late there has been much talk

about New York being a low-wage center. Data have been cited showing New York to be 19th of 20 metropolitan areas in average hourly earnings. Average earnings are lower because New York is a center for light consumer goods industries, which pay considerably less than heavy manufacturing. Given its industrial "mix," however, New York is a high-wage area and suffers from considerable interregional competition.

The production of women's clothing, for instance, has been migrating to the labor-surplus, depressed hard-coal region of Pennsylvania, where the wives and daughters of unemployed miners have been willing to take jobs at just about any wages offered. The increase of apparel production in Massachusetts is similarly related to the decline of the textile industry there. In recent years the South, with abundant sources of female labor, has grown as a center for the production of clothing and other light consumer goods.

Most suitable location

Despite the relative loss of wage-oriented sectors of many industries, the New York region has held on to about 12 per cent of the nation's manufacturing employment. The region has continually attracted rapidly growing industries because of the environment it offers them—many specialized subcontractors to service small producers, ease of communication with multitudes of suppliers and buyers, pools of labor possessing varied skills, and productive facilities which can be contracted for. All these reduce the investment requirements of newly established companies. Industries, therefore, which manufacture changing products, and products which are neither standardized nor can be produced in a standardized and routine manner, find New York a most suitable location in which to operate.

The electronics industry illustrates this. The early experimental work in both radio and television was done in the region; but once these industries were firmly established—with mass markets and mass production techniques—they sought locations closer to markets or with cheaper labor and factory sites. Meanwhile, newer types of electronics—high fidel-

ity and stereophonic sound—were growing in New York.

What is true of electronics holds equally well for many other manufacturing industries. Since new products and new industries are continually being developed, there is every reason to anticipate that New York's role as an industrial "nursery" will compensate for losses of jobs to interregional competition.

Magnet for labor

Looking into the future, by 1985 the population of the New York metropolitan region is expected to reach 24 million and its per capita income \$4,350. The workweek will probably be reduced to 32 hours. High birth rates will provide most of the population increases, all of which will take place outside of the city, but New York will remain a magnet attracting labor from elsewhere. Bright young men and women seeking jobs in the "brain and glamour" pursuits will continue to flock there. A shortage of labor in New York will probably continue for another decade, and Southern Negroes and Puerto Ricans will go on moving there to take the lower-paying jobs. The close to two million Negroes and Puerto Ricans in the metropolitan area at present are expected to increase by approximately 60 to 75 per cent by 1980.

While the newest migrants will be starting at the bottom of the ladder, Negroes and Puerto Ricans, as such, will not necessarily be stuck down there. As with other ethnic groups, the children and grandchildren of the original migrants will enjoy economic upgrading, they will get better jobs, develop a more stable family life and achieve higher status.

Despite pessimistic predictions for individual sections of New York's economy, the over-all picture of the region's future seems fairly bright. The region as a whole—not New York City or the other major urban centers in the region—will continue to grow. Its major strength is the diversification of its economy. This means that the decline of one or two industries can be offset by gains in a number of others. Some jobs, of course, will be lost; competition from other ports and increased productivity will probably reduce waterfront employment, and the garment indus-

try complex may need fewer operators, hand sewers and pressers.

But these losses will be more than made up by gains in other manufacturing in the suburbs and in office functions everywhere. New York City's population may not grow, but the number of jobs within it should jump by half a million over the next quarter-century.

Manhattan will continue to be a mecca for the trades, professions, industries and businesses where face-to-face contact is important. The Manhattan luncheon table has been described as a "provider of ideas" far more valuable as a cost saver to some types of pursuits than the lower cost of labor, space or transportation in other locations would be. The design and merchandising of apparel, for instance, will remain heavily concentrated in Manhattan, though production will decline.

New York's role as the nation's cultural center seems more secure than ever. Publishing, art, music and

the theater are heavily concentrated in Manhattan, and all the indications are that this will continue.

If the problem of transporting workers from their suburban homes to Manhattan offices can be solved, and if more middle-income housing is constructed so that the island does not become merely a place for the very rich and the very poor, there need be no letup in the building of new office structures. New York will remain the nation's financial center and headquarters for a very large share of the leading corporations. As such it will also be the center for top management personnel.

The future of the metropolitan region, therefore, seems brighter than many have assumed. It is possible to predict that New York will continue to absorb the poorer surplus populations of other areas, and, at the same time, provide the climate, opportunities and jobs that attract young people of talent from every corner of the nation. ■

The national budget and the economy

A Study in Interaction

by EDWIN G. NOURSE

■ WHEN I was doing a hitch of public service in the Executive Office of the President, we—i.e., the Council of Economic Advisers—gave President Truman early each month a bird's-eye view of how the economy was doing. This took the form of a loose-leaf binder containing some 16 statistical charts with a bare minimum of text comment. It was labeled "The Economy in Operation" and was complemented by a similar chart-book brought to him each month by the Bureau of the Budget, labeled "The Budget in Operation."

This procedure illuminated two facts that every studious citizen should know. First, the state of the economy and the condition of the national budget are two sides of the

same coin. Second, both the economy and the federal budget, which keeps books for a major segment of the economy, are living things, not an automated economic machine and an ossified financial plan, respectively. The President's policies must adapt themselves to unfolding events and expanding knowledge; the budget must roll with the punch of intra-governmental and public pressures and the decisions of the Congress—as well as market forces and business responses to government moves.

These considerations need to be borne in mind as we watch President Kennedy wrestle with the needs and possibilities of the New Frontier, while he also attempts to read the riddle of recession's depth and dura-

tion, and probe the enigma of the economy's probable response to this measure or that.

As a practical matter, the budget-making President must "keep three balls in the air at once." During his first year in office, Mr. Kennedy must juggle three annual budgets (and the related economic and military policies), two of which bear the Eisenhower impress but all three of which will be given the final stamp of JFK.

It is his immediate task to administer actual expenditures and some revenue operations of the last six months of the Eisenhower budget (as modified by the 86th Congress) for the fiscal year 1960-61. This he must do amidst the criticisms and urgings of the new Congress and its further modifications.

Second, President Kennedy must work with his Cabinet, his Council of Economic Advisers and his newly appointed Director of the Budget to reshape the July 1, 1961, to June 30, 1962, budget submitted by Eisenhower, as required by law, on January 16, 1961.

Third, he must preview, with all these agencies and other branches of the federal government, the kinds of estimates of needed expenditures and available revenues that will have to be reconciled in the budget for fiscal 1963—the first one that Mr. Kennedy will be able to shape "from scratch."

We start, therefore, with the question: What is being done to update the budget that was inherited from the outgoing Administration? Events have pretty well shown that that budget underestimated the severity of the recession. Furthermore, candidate Kennedy made it plain that he believed that the government should set higher goals of economic progress and intervene more actively to attain them than had the previous Administration. Now he is deep in the task of redeeming those promises.

Considerable powers

Let us look at his actions relating to the last six months of the 1961 budget. The President has quite considerable powers to retard some items of federal expenditure under a budget already approved by the Congress and also to accelerate some expenditures when he is convinced that this will arrest recession or speed re-

covery. There are also "supplemental appropriations," yearned for by the various Departments or other executive agencies, for which the Presidential smile or frown can be brought to bear upon Senate and House before these requests are acted upon.

In the present instance, President Kennedy is convinced that a budget as austere as the one he inherited from President Eisenhower, for the year ending June 30, 1961, would not be consistent with the policies of a New Frontier or with the best interests of the economy. He has, therefore, moved promptly to do something about it. In this, he has been undismayed by the fact that his rulings would contribute to a deficit which is now a virtual certainty come June 30, instead of the projected surplus.

That surplus was estimated in the budget submitted to the Congress in January, 1960, at \$4.2 billion. But in the ensuing months, the 86th Con-



John F. Kennedy

gress approved raises in the pay of federal employees and increased spendings for defense, the space program, several welfare activities and loans for veterans' housing. At the same time, it failed to accept the President's recommendations for revenue increases from revised postal rates, higher taxes on aviation gas and a new tax on jet fuels. The Congress made minor offsetting changes; but when the Budget Bureau in October, 1960, reviewed their probable net effect, it estimated that total expenditures would be \$600 million above the original estimate. On the revenue side, it revised the January estimate downward by \$2.5 billion. This reflected poorer business con-

ditions than had been foreseen, and the consequent shrinkage of individual and corporate income taxes and minor sources of revenue.

Taken together, these two adverse changes pared \$3.1 billion from the hoped-for surplus but still showed an estimated black-ink balance of \$1.1 billion as of June 30, 1961. It was not long after this October report that President-elect Kennedy took a fresh look at the state of the economy and the "budget in operation" in order to make a start on his economic and fiscal statesmanship for the coming session of the Congress—and for the ensuing years of his Administration.

Novel procedure

On January 30, the new President, following a novel procedure, addressed the Congress in person with a State of the Union Message designed to supersede President Eisenhower's Message, which had been submitted on January 12 in accordance with the traditional interpretation of a Constitutional provision. The keynote of President Kennedy's diagnosis was: "The present state of our economy is disturbing. [After] seven months of recession, three and a half years of slack, and seven years of diminished growth . . . the American economy is in trouble."

Turning to matters of policy and action, the President continued: "This Administration does not intend to stand helplessly by. . . I will propose to the Congress within the next 14 days measures to improve unemployment compensation . . . provide more food for the families of the unemployed . . . redevelop our areas of chronic labor surplus . . . stimulate housing and construction . . . secure more purchasing power for our lowest paid workers . . . offer tax incentives for sound plant investment . . . increase the development of our natural resources . . . encourage price stability . . . [and] other steps aimed at insuring a prompt recovery and paving the way for increased long-range growth. . . It is, I hope, a national program to realize our strength."

Not all of this bulging legislative package was in fact delivered within the promised 14-day period, but special messages have gone up to the Hill at a lively rate. And on March 6, Dr. Walter Heller, the new Chair-

man of the Council of Economic Advisers, inaugurated a novel procedure for the Council. He submitted to the Joint Economic Committee—in person and subject to interrogation by Committee members—a 56-page “statement” entitled “The American Economy in 1961: Problems and Policies.” This document amounted to a new Administration economic report—with recommendations—vis-à-vis the Economic Report of the President transmitted by President Eisenhower to the Congress on January 18.

Finally, on March 24, there went to the Congress a budget for fiscal 1962 that was completely overhauled except for its defense section. This had been prepared by the Bureau of the Budget under the immediate supervision of the Director, David Bell, a former White House aide under Truman and one of Kennedy's first appointees to a top federal office, and of Robert Turner, another former White House aide and Truman's last appointee to the Council of Economic Advisers. Thus was virtually completed the transition from the economic statesmanship of Dwight Eisenhower to that of John F. Kennedy.

Obviously, the Bureau's revised budget had been shaped at every step to express in dollar terms the economic philosophy and policies of the Chief Executive, just as the Heller statement had faithfully reflected in analytical and statistical terms Mr. Kennedy's appraisal of economic conditions, needs and potentials. The President's sense of mission focused, first and foremost, on hastening business recovery and promoting sustained economic growth at the maximum practicable rate. He also stated clearly that he intended to achieve this objective without sacrificing a reasonably stable dollar, both for the sake of domestic price and income relationships, and for our foreign exchange position.

Grand strategy

In his January 30 message to the Congress he said: “Whatever is required will be done . . . to make certain that, in the future as in the past, the dollar is as sound as a dollar.” Again, he said he would “protect the dollar,” specifically, not raise the purchase price of gold and

“not distort the value of the dollar in any fashion.” He concluded: “. . . this is a promise.”

This grand strategy of quick recovery from recession, sustained maximum growth thereafter, and the maintenance of a stable dollar calls for tricky tactical decisions as to choice and combination of weapons, scaling of effort and timing of maneuver. The available weapons fall within three general categories—government spending, taxing and regulation, all controversial.

Demands are loud for massive public spending to raise “aggregate demand,” or to give a shot in the arm to any industry not currently enjoying the boom conditions it had become accustomed to or to any locality lagging in the race for universal affluence. There are, on the



Budget Director David Bell

other hand, bitter complaints against “oppressive,” “incentive-destroying” or “confiscatory” taxes and pleas for tax cutting in general as the quickest and surest way of stimulating consumer purchasing and business investment—and thus of expanded employment, revived profits and enlarged government revenues.

But the professional doctors of economics and the trained nurses of business in corporation and union headquarters are by no means in full agreement as to how helpful a particular economic medicine would be—either in general or in any specific case. Nor do they agree about proper dosage or the patient's natural recuperative powers and possible allergies. The White House and Congress have to make their own ultimate choice among alternative methods of treatment.

Candidate Kennedy felt moved to

awaken the country to his sense of the reality and seriousness of the recession. President Kennedy called on Chairman Heller of the Council of Economic Advisers to spell out the situation as it was in February, 1961. Heller's March 6 “statement” estimated the decline from early 1960 to January, 1961, as eight per cent in industrial production, seven per cent in retail sales and 1.5 per cent in nonagricultural employment—or a total of 6.6 per cent of the nation's labor force unemployed. This document expressed special concern at the persistent gap between actual gross national product and the economy's estimated potential. As the Heller statement put it: “This gap of about \$50 billion (1960 prices) defines the urgency of the economic problem facing the nation today and in the months ahead.”

The strategy of the commander in chief has shown three basic elements: consumer relief, production stimulation and maintenance of the government's revenue base. Foremost under consumer relief was the President's drive to extend unemployment insurance by 13 weeks and to widen its coverage. Here he was simply reinforcing a line of government (and private) effort which, on the basis of experiment and experience, had gained widespread acceptance as a stabilizing factor in an enterprise economy. The present seemed to him just the time to increase such public expenditures to provide consumer (and merchant) relief in the short run and better market stabilization in the long run. As a further measure of relief to low-income consumers, the President pressed the Department of Agriculture to increase domestic surplus food disposal.

Manifest desire

The same desire to use government spending to strengthen activities, good in themselves and most in need of intensification, has been manifest also in the stimulation of private production. This involved issues of allocation of government aid. Instead of a blunderbuss program of spending just because it would increase aggregate demand, the President selected “depressed areas” as the targets of riflelike shots intended both to relieve present distress or discouragement and permanently re-

move weaknesses in our national economy. Aid to education was a second major part of this selective expansion of public enterprise to stem recession and accelerate future growth. Aid to housing, higher farm income and better medical care also have their places as the program unfolds.

As to the third objective—maintenance of the government's revenue base—there had been widespread fear, still lingering in various quarters, that the new Administration's sense of urgency would lead to reckless spending, soft credit policies, tax slashing and unleashed inflation. Thus far, these fears have been somewhat assuaged not only by the promise to protect the dollar already quoted above, but also by the fact that in several important instances Mr. Kennedy has pared his budget recommendations to the Congress below those he had himself talked of during his campaign and also below those the "eager beavers" of his party were demanding—notably for aid to education and for social security.

He also refrained from "pushing the panic button" on tax cutting (a measure favored by Heller) as well as on spending to stimulate the economy. Instead he waited to see what powers of natural recuperation the private economy would show once inventory liquidation had run its course and springtime's economic weather could be appraised.

The President has settled on his several lines of policy and put a price tag on each. Having done so, he must await the often slow deliberations of Congressional committees, seek to spur them or arrive at workable compromises—with a possible assist from public opinion in general, or the propaganda of particular groups or regions.

Budget Bureau keeps score

On the Bureau of the Budget, in consultation with the Council of Economic Advisers, the Treasury and other government agencies, devolves the complicated and hazardous task of trying to measure the probable effects of this ever-changing legislative program on the no less unpredictable course of business activity, private incomes and government revenues. On March 24 and March

27 (in separate defense and nondefense messages), President Kennedy presented to the Congress his revised budget for fiscal 1962. Beginning with a review of the last six months of the current budget, the Bureau forecast a deficit for this year of almost \$2.2 billion, in place of the surplus of \$1.1 billion which had looked possible last October, or of less than a hundred million hoped for in January.

This deterioration, it said, was due in part to the recession. But there had also been a failure in the Eisenhower budget to recognize or include certain obligated expenditures. Also, the 1961 budget had "unrealistically assumed that the Congress would enact a record (though necessary) postal rate increase . . . in time to take effect April 1 [1961]. . . . The deficit thus inherited by this Administration for fiscal 1961, augmented by the essential antirecession and national security steps already taken or recommended to the Congress, is now estimated to total over \$2 billion. . . ." About one-fourth of this deficit will come from the temporary extension of unemployment benefits. Under the law signed by the President on March 24, these payments began early in April.

Turning to the new (fiscal 1962) budget, the President began by quoting from his January 30 message to the Congress: "A new Administration must of necessity build on the spending and revenue estimates already submitted. . . . It is my current intention to advocate a program of expenditures which, including revenue from a stimulation of the economy, will not, of and by themselves, unbalance the earlier budget." The increased expenditures he thereupon recommended totaled approximately \$2.3 billion. This was the net result of additions in 43 categories and cuts in five categories. Of the \$2.3-billion increase, 83 per cent was for four executive agencies: \$793 million to Health, Education and Welfare; \$478 million to Agriculture; \$431 million to Labor; \$214 million to Housing and Home Finance.

Adding this increase to the Eisenhower estimated expenditures of \$80,865,000,000 gave a prospective outgo of \$83,187,000,000 (before revising estimates for defense). Then

the President reduced the Eisenhower estimate of revenue from \$82,333,000,000 to \$81,433,000,000 "based on more realistic economic assumptions" and took advance credit for \$900 million "added revenue from increased economic activity generated by new proposals." Subtracting this hoped-for revenue (\$81,433,000,000) from the Eisenhower spending figure (\$80,865,000,000) plus the approximately \$2.3 billion for new proposals, left a prospective deficit of \$1,754,000,000 as of June 30, 1962 (still excluding defense increases).

Since the revenue figure included \$843 million of increased postal rates, yearned for by Kennedy no less than Eisenhower, but loathed by the Congress, so favorable an outcome is by no means assured. Furthermore, the cost of new proposals included in this budget are for nondefense items only, whereas the President, on March 28, sent to the Congress a special budget message containing re-estimates of existing schedules and recommending enlarged defense expenditures together amounting to about \$940 million. Should this be agreed to—or enlarged—and the postal rate recommendation turned down, the prospective deficit of \$1.8 billion (excluding defense increases) would be considerably exceeded. The President proposes but the Congress disposes. Both its action and the initiatives and responses of the private economy are highly unpredictable.

Bird's-eye view

As an oldster (crowding 78), an economist (ex-Chairman, Council of Economic Advisers; ex-President, American Economic Association; other ex's), and a citizen (with the limited voting rights of an inhabitant of the District of Columbia), I contemplate this situation and process not only with satisfaction but with sober pride. It seems to me to present a cross-section of the economic and political life of a free people—whether you call it a democracy or a representative republic—maturing into competent use of the intellectual tools of modern economics and statistics in the handling of their national affairs.

There are, to be sure, plenty of evidences of special pleading, disingenuousness or even political cyn-

icism at many spots. The March 24 budget message charges the preceding Administration with window-dressing and then proceeds to some rather fancy window-dressing of its own.

The new document is clearly designed to put the onus of the inevitable deficit on the "predecessor" and to maximize for this Administration the credit for any recovery. When the sun of prosperity again rises, attention is to be focused on the crow of Chanticleer rather than the play of natural forces.

Similarly, there are able economists who would argue that making enlarged unemployment benefits effective immediately and postponing the related increase in employers' taxes till January, 1962, is a sound stabilization device. But there are also acute politicians who see this as "vote-buying."

But this is good, clean fun on a pretty respectable plane of intellectual debate. What we are witnessing during these months—and these years—seems to me to furnish an object lesson to other countries and

especially to those countries, still more in need of practical examples, who are now aspiring to be free—and viable. It appears to me to be an object lesson in peaceful but not supine coexistence of divergent value schemes, and rival group and sectional interests, coupled with vigorous but discreet leadership in both the executive and the legislative branches of our national government, and also featuring lively participation in opinion making by an educable body of citizens steadily rising above the level of economic illiteracy. ■

The research explosion

Less Noise, More Research

by **DANIEL HAMBERG**

■ A VERITABLE EXPLOSION of expenditures on research and development (R&D) has occurred in the U.S. economy in recent years. Current research, because of its magnitude and rate of advance, has inspired awe and generated a torrent of enraptured prose. This outpouring describes the promise research holds for lifesaving and life-serving new products and processes. The importance of technological change to our present living standards has recently been statistically verified in a number of independent studies. Economists have shown that 80 to 90 per cent of our economy's advances in productivity (output per man-hour) originated in technological progress.

To some extent these figures represent exaggerated claims for technical change. For great improvements in the quality of the labor force and management as well as better organization of industry have undoubtedly fostered much of the advance in productivity and living standards. But a comparison of the goods on the market today, and the

production techniques used to make them, with the goods and techniques of yesteryear dramatizes the contributions that inventions have made to the rapid advance in our living standards.

—With R&D being conducted on an unparalleled scale, the future is apparently filled with *potential* well-being on an equally unprecedented scale. But it remains to be seen whether this promise will be realized. One of the interesting features of the recent research explosion is that it has thus far failed to show up in the estimates of productivity.

It is true that output per man-hour grew by 3.3 per cent a year between 1945 and 1957 (the latest period for which authoritative information is available) and that this was well above the long-term rate of 2.4 per cent. But similar high rates of productivity growth occurred in earlier periods for comparable lengths of time. Also, the recent surge has been induced primarily by the great spurt in agricultural productivity—a spurt caused chiefly by

organizational changes which had relatively little to do with the boom in research and development.

It is hard to determine why the increase in R&D has apparently not increased productivity, and efforts to evaluate the research explosion in these terms may be premature. Nevertheless, it may be worthwhile to look at the over-all character of the research explosion to see whether we can find suggestive clues. All that glitters may not be gold, and the realization of the promise of R&D may prove to be more of a challenge to private and public policy than we realize.

Because private industry has been conducting more than 75 per cent of all organized R&D, let us first examine the record of this sector of the economy.

In 1959 private industry spent \$9.4 billion on R&D. Of this amount, \$5.4 billion (or 57 per cent) was financed by the federal government and the remainder by industry itself. Total R&D spending by industry was about \$170 million in 1929; this figure rose to \$350 million in 1940 and hit \$2 billion in 1950. Thus, between 1929 and 1959 industrial R&D programs increased by 5,400 per cent; even between 1950 and 1959 the increase was more than 450 per cent. Much of this growth, it must be noted, is exaggerated by inflation and by broadened definitions of research and development, induced partly by public relations factors and partly by tax law changes.

Current dollar figures, therefore, overstate the real increase in R&D activity. An allowance for inflation

reduces the increase between 1929 and 1959 by about one-half. How much further it should be reduced by correction for changing definitions is impossible to say. Such further adjustments would probably still leave the total increase in R&D activity for the 30-year period at about 2,000 per cent—an extraordinarily impressive rise.

During 1953, the most recent year for which there are data, nearly 20,000 companies participated in the country's R&D effort. About 15,500 firms conducted R&D on their own premises, and about 3,700 companies without R&D programs of their own supported projects performed by outside organizations.

It is also well to get some perspective on the place of industrial R&D in the total picture of American research and development. We can best do this by examining some figures for the latest decade—the one in which R&D really began to mount in magnitude and scope.

Fifty-five per cent of the funds for financing all R&D activity during the 1950s came from the federal government; most of these expenditures, of course, were for defense purposes. Private industry, on the other hand, supplied an average of 41 per cent of all R&D funds during the Fifties, and colleges and other nonprofit institutions four per cent.

These figures are in marked contrast with those of earlier years. In 1930 the federal government financed

used to be distinctly profit-oriented, and under the influence of the patent system and other social controls, much of it is now strongly influenced by political and defense considerations.

The proportions of R&D *financed* by each of the three sectors of the economy are by no means the same as the proportions of R&D *performed* by each of them. During the Fifties, private industry performed an average of 71 per cent of all R&D work, government 18 per cent and nonprofit institutions 11 per cent. These figures represent a rise of about 20 per cent in industry's share of the conduct of all R&D work since 1930.

The pronounced change in the sources of research funds is, of course, explained by the very large increase in federal funds for research and development and the use of such funds to sponsor research in the private sector of the economy—primarily industry. In recent years, the federal government has been contracting out 60 to 65 per cent of its R&D funds to industry alone, with another 12 to 14 per cent going to colleges and other nonprofit institutions.

It should be stressed at this point that there is a world of difference between research and development. Development begins where research ends. When an invention or model has been proved technically feasible, it is developed for the market. This

than research; development expenditures tend to run at from two to two and one-half times research expenditures. Therefore, total R&D figures are not a good measure of inventive activity. Research figures alone are a better yardstick.

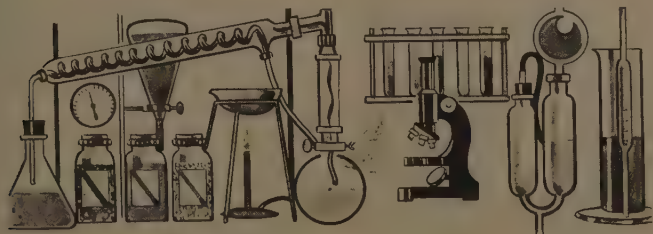
In turn, research is divided into basic and applied research. Basic research extends the boundaries of knowledge, but has no technological or commercial objectives. In contrast, applied research seeks new or improved products and processes. To a considerable extent, applied research builds on basic research; this is especially true in those fields where progress has been founded upon advances in physics and chemistry—e.g., the chemical, petroleum refining, electrical equipment and electronics industries. Surprisingly enough, many industries are based not on science, but on the older empirical arts—for example, mining, textile manufacturing and household goods industries.

Broad interpretation

Even experts cannot agree on the line between basic and applied research. And businessmen frequently see as basic research many activities that experts regard as applied research. More important, however, is the fact that business tends to give the term "applied research" a rather broad interpretation. A company bringing out a new shade of lipstick, or a higher octane gasoline, or another detergent, or a new car will call these "new" products and impute to them significant amounts of applied research. But clearly the amount of research that goes into such products is small.

Certain industries are notorious for their small expenditures on research relative to development. An example is the automobile industry, which boasts of annual expenditures of more than half a billion dollars on unsubsidized R&D. But the automobile companies persistently refuse to provide a breakdown of their figures between applied research and development—a revealing state of affairs.

Thus, published R&D estimates, particularly those involving breakdowns of R&D activities into their major components, should be used with caution. Nevertheless, these



only 14 per cent of total R&D activity, whereas private industry paid for some 70 per cent and nonprofit institutions for the remainder. The greatly increased role of government in financing R&D must have changed the pattern of incentives and controls germane to inventive activity. Whereas the bulk of industrial R&D

development stage is highly important. It often calls for great technical skill, engineering knowledge and resourcefulness. But the types and levels of talent required in development are distinctly inferior to those needed for original and creative research and invention.

Development costs much more

data do give us rough ideas of orders of magnitude in the different categories of R&D and some insights into possible trends.

In 1959 some \$12 billion was spent in the U.S. economy on research and development (compared to about \$220 million in 1929). Of this total about 70 per cent was for development alone, 22 per cent for applied research and eight per cent for basic research. Somewhat similar proportions prevailed throughout the Fifties, although there has been a discernible upward trend in the *relative* importance of development at the expense of both basic and applied research. The *absolute* amounts spent on all three activities have, of course, been rising sharply.

Representative proportions

Of the \$960 million devoted to *basic* research in 1959, colleges and other nonprofit institutions performed 58 per cent, industry 28 per cent and government 14 per cent. Outlays on *applied* research were \$2.7 billion in 1959. Industry conducted 65 per cent of this research, colleges and other nonprofit institutions 19 per cent, and government 16 per cent. As for development, industry conducted 85 per cent of the work in this category, government 12 per cent, and colleges and other institutions only three per cent. All these proportions are fairly representative of the entire decade of the Fifties.

In all, industry performed more than \$9 billion worth of R&D work in 1959. Of this total, 78 per cent was for development, 22 per cent for applied research and only three per cent for basic research. It is interesting to note that the *relative* importance of basic research in industry declined considerably since 1950. The relative importance of applied research also declined slightly.

Turning to colleges and other nonprofit institutions, we find that in 1959 they performed \$1.3 billion worth of R&D. Of this, 43 per cent was for basic research, 40 per cent for applied research and 17 per cent for development. The relative importance of applied research and development is surprising in a sector that has been the historical source of advances in basic science. What is even more a cause for concern is the drop

in the relative importance of basic research in this sector in recent decades.

The extent of the shift in the composition of research and development—mainly at the expense of basic research—is illustrated by a comparison with some earlier figures. During the 1920s, colleges and other nonprofit institutions accounted for approximately 20 per cent of all R&D expenditures and during the 1930s for about 15 per cent. Before World War II these groups, especially the colleges, confined their activities almost exclusively to basic research; industry and government also performed some basic research, but in their case in quite marginal amounts.

We can, therefore, use the figures for nonprofit institutions as estimates of the relative importance of basic research in the total R&D picture during the interwar decades. In 1959, spending on basic research accounted for only eight per cent of total R&D, a decline in the relative importance of this strategic activity of some 60 per cent from the 1920s and of almost 50 per cent from the 1930s.

The statistics available, it is worth noting, exclude the work of the independent inventor. This makes them an incomplete measure of current inventive activity. The inventor working outside the industrial laboratory is still a prime source of major inventions. There is strong evidence that as many as 50 to 60 per cent of today's inventors are outside the organized research groups. Between 1950 and 1957 an average of 16,000 patents a year were issued to independent inventors, and an estimated 40 to 50 per cent were put to commercial use. Recent studies show that this compares favorably with the use made of patents owned by large corporations.

Nevertheless, if the patent data are a good indicator, the independent inventor has declined greatly in importance. The average number of patents issued to independents in the early Fifties was but one-half the peak reached in 1916. Moreover, in 1900 over 80 per cent of all patents were issued to independents and less than 20 per cent to corporations. In 1957 independents obtained but 36 per cent of the total, corporations 61 per cent, government two per cent.

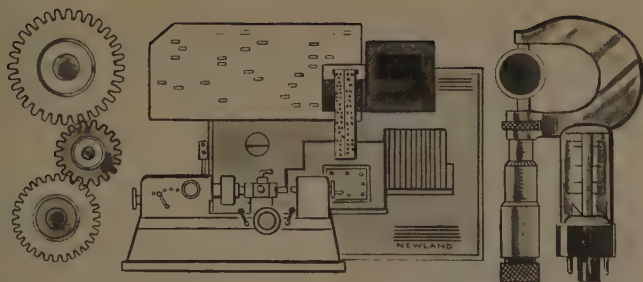
It is well to question the virtues of group research which has largely replaced the independent inventor. Indeed, there is much evidence to indicate that many of the new products attributed to group research turn out, on examination, to be chiefly the work of one principal researcher. He may be surrounded by a group of laboratory assistants and he may work with elaborate equipment, but these facilities would produce little without him. Freon refrigerants, tetraethyl lead and nylon are examples of products that were discovered by group research. But in each case one person was the chief inventor.

To sum up, then, we can say that there has indeed been a research explosion. However, the phenomenal increase in R&D work has been marked by (1) a heavy preponderance of development work as opposed to research and a sharp downward trend in the relative importance of research, especially basic research; (2) a radical shift in the sources of R&D funds from private to public sources; and (3) a rise in the relative importance of industrial R&D activity, *vis-à-vis* that performed by nonprofit institutions, the government and independent inventors. What implications do these facts have for private and public policy?

That research, particularly basic research, has been relatively neglected in the U.S. will come as no surprise to many readers. But to learn that basic research in 1959 comprised but eight per cent of total R&D, three per cent of industrial R&D and 43 per cent of that performed by colleges and other nonprofit institutions must come as something of a shock. For most of our country's existence, we have lagged in basic research and have relied mainly on Western Europe. Yet there has been an alarming decline of 50 to 60 per cent in the relative importance of basic research in our over-all R&D effort since the 1920s and 1930s.

Expensive alternatives

The extreme imbalance between basic research on the one hand, and applied research and development on the other, poses a real danger to the productiveness of future applied research and development. When in-



dustry can draw on well-advanced basic science, the costs in time and effort of applied research and development can be expected to be much lower than otherwise. Basic scientific breakthroughs often facilitate invention; they are no less important in speeding up development and making it less costly. The alternative to operations from an advanced scientific base are expensive and time-consuming empirical methods.

A dramatic example of the costs of a weak scientific base is to be found in our ballistic missile program. The unreliability of our ballistic missiles after billions of dollars have been spent on applied research and development, mostly on the latter, speaks volumes.

Concentrated in few industries

It is no accident, either, that the nation's R&D effort is concentrated in so few industries, such as the electrical equipment, machinery, chemical and petroleum industries. (The aircraft industry alone accounts for about a third of total R&D, but the vast bulk of its activities are financed and influenced by the federal government for defense reasons.) These industries all operate on more or less well-developed scientific bases. Almost without exception, most of our remaining industries conduct next to no R&D, or, like the auto industry, concentrate on development rather than research. These industries operate on the basis of little basic science.

It is important, then, that when we rejoice in the magnitude and growth of our R&D effort, we be sure what we are rejoicing about. Our research effort is, or should be, a cause for worry, for basic research is obviously still being undersupported and underemphasized. In industry, most

firms simply refuse to support much basic research.

Although proposals have been made for stimulating industry's participation in basic research through special tax incentives and forms of subsidy, such incentive schemes are unpromising. The reasons are inherent in the nature of basic research: lacking a specific commercial or technical objective, it is next to impossible to determine what will come out of it, and very few companies are so diversified that they can use whatever is discovered. In addition, basic research takes a long time to pay off, and most firms prefer their investments to produce profits as soon as possible.

Nevertheless, there are real advantages to firms engaging in basic research. The intellectual tone of industrial laboratories rises, and with it the caliber of applied research and development; this, in turn, attracts better scientists and engineers. Despite these advantages, however, basic research in industry is likely to be limited to a few large and highly diversified companies—and most of them defense contractors.

We shall have to continue to look to the universities and government for the future increases we need in basic research. This being the case, the 14 per cent decline since 1945 in the relative importance of basic research at colleges and other non-profit institutions must arouse dismay, especially since there has been no offsetting increase in the government's basic research.

Ironically, the federal government itself bears a heavy responsibility for the relative decline of basic research by the universities. Since World War II the government has been pressing the universities to work on engineering and development problems associated with defense. As a result,

these institutions have been drawn into the "hardware" end of research and development on an unprecedented scale.

Many university professors, anxious to supplement their incomes, have sought government grants, even to the extent, in some cases, of compromising their main research interests or changing their research fields to secure financial support. Hence the search for new, truly basic knowledge, which is the duty of universities to carry on, has been displaced in part by efforts to solve problems for government agencies.

The trend toward government-supported and government-directed research in the universities has had its counterpart in a large increase in applied research and development sponsored by industry. Indeed, many university science and engineering departments are deeply immersed in various forms of industrial research and engineering consulting. Both industry and government are in the process of squeezing the lifeline on which the long-run viability of their future R&D programs depends.

Educated hacks?

These activities have had other insidious effects that bode ill for the future quality of our nation's R&D effort. Graduate students—the source of our future supply of scientists and technologists—find themselves being directed to work along conventional lines instead of being encouraged to undertake basic research. As a result, we are faced with the danger of producing a class of educated hacks, of being deprived of many top-notch scientists who might make great intellectual breakthroughs that would fortify and advance all of our future R&D efforts.

Added to this, scientific personnel have lately been departing from the universities, lured by the higher salaries they can usually obtain in industrial laboratories. In addition to being lost to basic research, they are being lost to education—a function certainly vital to the extension of knowledge.

It is clear that if the research revolution is to be maintained and its quality raised, it must be enriched by more basic research activity than we now support. In the end, this would likely entail vastly increased

subsidies—mainly to universities—for basic research. These would enable the universities to resist the attractions of government and industry research contracts, and to retain and expand their scientific staffs and basic research programs. Government and industry both had better quickly revise their present practice of deflecting interest from truly basic scholarship. The universities must not fail in the conduct of this crucial function, for no other agency can be counted on to take up the slack.

There is also need for industry to raise the level of its *applied* research programs. There is much evidence that industry tends to concentrate too much on applied research that features the short payoff. As a result, much of its inventive activity is con-

cerned with marginal improvements featuring process and product development.

Considering how much money industry has been spending on R&D, it is truly astonishing how few radically new inventions have originated in this sector, especially among the large firms. Far too many resources are being devoted to development activities that have been dignified by the term "research." If industry insists on diverting scientific and technical personnel from other activities, it is time that it became more alive to its social responsibilities. For, in the long pull, it is the basic inventions of applied research which, combined with the fruits of basic research, maintain the stream of technological progress. ■

posted prices. The Soviet offers, however, have an additional feature—they permit payment in local products or in local currency.

The experience in Cuba has been the most extreme to date. The Soviets agreed to take a million tons of Cuban sugar a year for five years, and to pay for this sugar through a combination of cash, oil and other commodities. The main refineries in Cuba, owned by Esso, Shell and Texaco, were each asked by the Cuban government to process 11,000 barrels a day of Soviet crude. This seemed a poor bargain to the companies, as it would reduce by this amount the market for oil produced by their affiliates in Venezuela. The request was, therefore, refused, and the Cuban government took over the refineries. The Soviet Union is now supplying all of Cuba's needs—some two million barrels a month. The amount of oil is not great—about two per cent of Venezuelan exports—but the approach leaves something to be desired.

In India, Soviet crude was also offered to the foreign oil refineries, but the government of India did not try to force the refineries to process the oil. The companies matched the Russian offer by cutting crude prices over 11 per cent. This seems to have averted a crisis. But it is not the end of the story. To countries like India, with limited foreign exchange, Soviet barter terms are attractive. It is therefore to be expected that India will import Soviet oil products on special terms. In Ceylon the Soviet Union has offered to supply oil and oil products in exchange for rubber and tea. So the story goes.

The situation for the oil companies is complicated. When they cut prices for India, Pakistan and other countries naturally began to clamor for similar cuts. But when widespread price reductions are made, the posted price of oil in Middle Eastern oil producing countries must be cut. This reduces the royalties paid to these countries and naturally causes dissatisfaction. In the middle—between the demands of the consuming and producing countries—stand the private oil companies. They are faced with the task of trying to achieve economic success in a situation with strong political overtones. Their problem is magnified

New front in the economic cold war

The Threat of Soviet Oil

by **JAMES F. McDIVITT**

■ SOVIET OIL is worrying the international oil companies. Though the absolute amount of Soviet oil moving into international trade is not yet large, there is every indication that it will increasingly compete in an already oversupplied market.

The Soviet state has political as well as economic motives for this trade. Therefore, in competing with the international oil companies, the Soviets have an advantage—they do not have to gear their operations to making a profit. They can also use methods, such as barter, that their competitors cannot. What does this situation foreshadow for the international trade in oil?

First let us look at the facts about Soviet trade in oil. Since 1950 surplus Soviet oil has been shipped to other countries in increasing quantities. Between 1957 and 1958 the U.S.S.R.'s oil exports rose by 32 per cent; between 1958 and 1959 they in-

creased by 39 per cent. Even so, the Soviets' 1959 exports to the satellite countries and Western Europe—their main market for oil—amounted to less than five per cent of the total moving in international trade. Apparently, the Soviet Union was selling oil to obtain foreign exchange; thus, most of it was marketed at close to the going price. However, the largest single customer—Italy's government-owned oil company—received substantial discounts. The private oil companies did not welcome this Soviet competition, but on these terms, and in these quantities, they could cope with it.

Recently, though, the pattern has been changing. Each month new Soviet offers at 10 to 20 per cent below posted prices have been made to areas currently served by the major oil companies. This, of itself, is often no bargain, as most of the companies have been discounting the

by the fact that they cannot duplicate Soviet offers of barter and special terms of payment.

The large international companies are mainly American, but much British and Dutch capital participates. These companies have controlled the production, processing, distribution and marketing of world oil to a remarkable extent. They have opened up vast areas of the world in their search for oil. They have also set up refineries throughout the world to assure outlets for the production of their widespread oil fields. There are, in addition, many medium-sized companies (which by normal business standards would be considered very large indeed) concerned with the search for and discovery of oil throughout the world. The existence of these companies ensures that the industry will remain competitive.

Risky and costly

There is a reason for the high degree of concentration in the industry. Oil is a very risky and costly business. Producing oil and converting it into usable products is no great problem. But finding an oil field, and then finding a new oil field to take its place when it is used up, is very complex and expensive. In this search for oil, the large companies have the staff, the equipment, the know-how and, above all, the financial resources to be able to carry on in spite of repeated failures. And inevitably there are repeated failures, for most exploratory wells are dry.

Lower prices, higher royalty rates or more restrictive leasing agreements will not greatly affect the ability of the companies to produce oil in the short run. Much oil is waiting to be pumped, and adequate processing facilities exist. But such changes might affect the ability of the companies to find new oil. If prices are forced down or conditions made difficult to the point that this search becomes economically or physically impossible, we will have enough oil only as long as our present reserves last—about 15 years.

As the producing countries become aware of the value of their oil and of their power over it, they experiment to see how much money they can squeeze out of the oil companies.



This is one of the types of risk that oil companies are conditioned to bear; they have been squeezed before. So long as the game is played according to economic rules, they can look after themselves. However, when political rules are used, private international companies are severely handicapped. It is difficult for them to compete effectively against governments.

The immediate problem is to find the best way for the major oil companies and producing countries to cope with the present oil glut. The longer-range problems must include meeting the challenge of the bilateral agreements the Soviets are using.

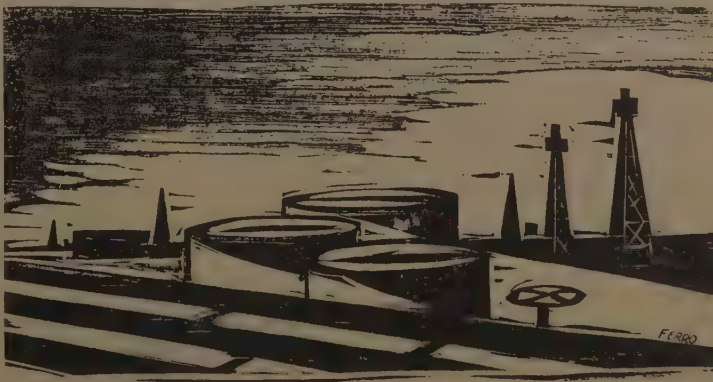
The Soviets do not have to use the same economic criteria in searching for oil as do the international oil companies. A private company must make a profit or go out of business. But in the U.S.S.R. the search for oil can be regarded as a national goal.

Although there is no reason to believe that Soviet oil production is uneconomic by our standards, in the U.S.S.R. oil is valued for its contribution to the strength of the economy, not because it produces a profit. Similarly, in selling the Soviets can discount their oil prices by the value of the political impact of the sales.

According to an article in a recent issue of the quarterly journal of the American Petroleum Institute, the Soviets plan to surpass the United States in oil production by 1972. Theoretically, it is possible for them to do so. It is also somewhat alarming that they want to; for even with an increase in domestic consumption far greater than seems likely, they would be left with a great deal of surplus oil. This will have to be disposed of in a world in which oil is expected to be abundant, and in which one of the Soviets' chief present markets, China, plans to be self-sufficient.

Such a surplus of Soviet oil could be sold abroad to provide foreign exchange. It could also be used as a tool in the Soviets' ideological warfare with the non-Communist world. Oil is an ideal weapon here. It is easily transported, it is universally used, it can be processed in existing facilities and transactions can be fast.

The impact on the oil companies is likely to be great. In the near future, the major international oil producers face a difficult problem. They must try to keep a balance between the producing countries, which aim at maintaining their rate of oil earnings, and the consuming countries, which are looking for bargains in oil. In such dealings they have much experience and skill, and,



in addition, have control over a large part of the facilities for producing, refining and marketing oil. However, as government interest in participating on all these levels grows, their position will become more precarious.

Traditionally, the American government does not give much help to these companies, and at times, in fact, they must feel that some government policies are designed to hinder them. Indeed, by withholding some degree of reasoned and considered support from our foreign companies at this time, we are forcing them to pit their strength against the Soviet state.

It must be emphasized that, at present, the amount of oil exported by the Soviets is relatively small and can be easily absorbed. However, in the present tight situation, any Soviet exports marketed on special terms create a disproportionate amount of confusion. They threaten the present pattern of supply. This endangers the future of the international oil companies, which are among the most successful examples of international free enterprise.

To date, the major appeal of Soviet oil exports has been to underdeveloped countries that are short of foreign exchange. We have noted that through offering oil to these countries on special terms, the Soviet Union is making life complicated for the oil companies. We should also note that the Soviet Union is helping these countries (one must be careful to look at apparent effect rather than suspected motive) in much the same way that we helped them in the past through selling them surplus wheat. Perhaps the problems of the oil companies are the side effects of a benevolent gesture, just as the problems faced by Australian wheat farmers were a result of our gifts of wheat to underdeveloped areas.

The developing countries need help. We want to help them, and we have been making great efforts to do so. They need oil. The Soviets offer oil, and if Soviet terms are best, they will buy Soviet oil. But private American companies with surplus capacity, long-established connections and ultramodern facilities are better equipped to supply the developing countries than anyone else

in the world. Soviet offers are attractive because they are more flexible than the rigid price and payment requirements on which a private company must insist.

Surely our system is flexible enough to achieve the limited degree of coordination between industry and government that would allow us to compete successfully on this level. After all, the Soviet Union does not give away oil—past experience shows that it usually gets paid very well in goods and money as well as in prestige for any help it provides.

The private companies, for their part, would not welcome closer ties with the government. But we have passed the time when they can operate successfully and with confidence against growing Soviet competition in this area.

Interested in stability

Increased Soviet exports must create problems for producing countries as well as for the international companies. The producing areas which would be most seriously affected are Venezuela and the countries of the Middle East. They provide most of the oil moving in international trade, and oil revenues make up a significant part of their incomes. They are interested in stability. And the free world must be interested in their stability, since any disturbance in the economies of these countries plays into the hands of the Communists.

In the past the oil companies controlled markets as well as supplies, and the oil producing countries made out rather well. The companies seldom engaged in active competition; the countries had a steady source of revenue. Now, new factors have entered the picture. Soviet bilateral agreements are only one such factor; there is also discount selling by private companies which have no assured markets.

Under these changing conditions, the oil producing countries are looking at their resources with growing concern. They do not like to see their oil—an irreplaceable asset—being sold at cut-rate prices. Thus, it is not surprising that when control by international oil companies showed signs of breaking down on the world level, the oil producing countries at-

tempted to safeguard their interests. The governments of the Middle East countries joined Venezuela to form the Organization of Petroleum Exporting Countries (OPEC) and have begun to talk of setting up international production quotas.

The international oil producers may end up by having to operate in foreign fields under the same type of production quotas they have faced in the United States for almost 30 years. Or some new pattern may be worked out. But it is most unlikely that they will be able to continue to operate as at present.

Another thing which the OPEC might achieve would be a limitation of Soviet oil exports. At a luncheon during his visit last year to the United Nations, Mr. Khrushchev noted that the Soviet Union has agreed to limit its exports of tin and diamonds, and that it would consider doing the same for other commodities. Oil producing countries, however, may be somewhat disturbed by a recent Soviet statement. This was to the effect that the U.S.S.R. expected to increase its oil exports to about three times their 1959 level.

How does all this affect Europe, which is the major and logical market for oil exports from both the Soviet Union and the Middle East? Foreign oil is vital to the countries of Europe, and they can have no objection to adding a new source of supply. Thus, as a new surplus develops, and new pipelines make the surplus more accessible, the flow to Europe can be expected to increase. But the countries of Europe have no currency or barter problems and they are in a position to drive hard bargains.

While it is possible that an international agreement may be worked out by which the Soviets would limit their exports of oil, we cannot count on it. Indeed, it is highly probable that the international oil companies will have to face increased Soviet competition. The Soviets, in waging the cold war by economic means, can undercut prices and offer barter agreements. The oil companies cannot be expected to meet this type of competition. In the end, it may prove necessary for the United States government—and, perhaps, other Western governments also—to take an active part in the struggle. ■

JACK I. STRAUS

Chairman of the Board, R. H. Macy & Co.



The Status of Retailing Today

Q *Mr. Straus, the statistics on retail sales are often cited as an index to the state of mind of the public, particularly during periods of economic recession. Does this mean that such statistics are a sort of bellwether of the economy, as well?*

A "Bellwether" literally means a leader, or one which precedes others. In this sense, retail sales are not a bellwether of general economic ups and downs. They do not necessarily indicate the imminence of turning points in business conditions.

Q *Is there any definite pattern in the performance of retail sales in relation to general economic conditions?*

A Yes, in the sense described above, apparently there is. As a matter of fact, a study of various business cycle indicators made several years ago by the National Bureau of Economic Research classified retail sales among the "lagging" group. On the average, between 1919 and 1938, retail sales reached their peak and began to turn downward 3.8 months *after* the economy as a whole had turned downward. Similarly, retail sales hit bottom and began to turn up 1.8 months *after* the economy had started to improve. In a new study, released only this week, which incorporates data on cycles since World War II, however, the National Bureau now considers retail sales as a roughly coincidental indicator. In any event, I am afraid that retail sales cannot be called a bellwether. Among the better leading indicators are statistics on the average workweek in manufacturing, business failures, new orders for durable goods and residential housing starts.

Q *Is there a significant difference between the way sales of durable goods and sales of soft goods have fared during the postwar years?*

A Yes, a very significant difference. On the whole, sales of soft goods stand up much better than those of durable goods in a period of economic downturn. But the exact amount of decline in one category or another of retail sales varies from downturn to downturn.

Q *Well, how have retail sales actually fared during the four postwar recessions?*

A In relation to the declines in gross national product,

retail performance in the past two recessions has been poorer than in the two earlier ones. If you look at the economy during the period from the peak month of November, 1948 to the trough of October, 1949, you find that gross national product declined by 3.2 per cent. But retail sales were off by only .3 per cent. During the period from July, 1953 to August, 1954 the gross national product was off by two per cent and retail sales by a relatively small .8 per cent.

Q *Those figures would certainly indicate an unwillingness on the part of the consuming public to panic in the face of temporary economic setbacks.*

A Yes, I think that is generally recognized. But then a change took place, at least according to the figures for the last two recessions. Between July, 1957 and March, 1958 the GNP dropped by 3.8 per cent. But, now note, retail sales were off by 5.7 per cent. Thus far, in the current recession, GNP dropped only .3 per cent from the second quarter of 1960 to the last quarter. However, seasonally adjusted monthly retail sales declined 4.9 per cent, or \$934 million, from their peak rate in April, 1960. But almost \$600 million of this drop was localized in the automotive group, which actually declined by 16.2 per cent. The drop in furniture and appliance store sales was 8.3 per cent, only about half as serious as in automotive sales, but higher than the over-all drop in retail sales.

Q *Would it be fair to say, then, that the drop in retail sales during the past two recessions was mainly due to declines in the sales of durable goods?*

A Certainly from the figures cited above on the present economic decline, it is evident that the retail sales drop in the automotive, furniture and appliance components of durable goods has been sharper than for retail trade in general. It would be fair to conclude that the soft goods have stood up fairly well throughout the postwar era.

Q *Would you say that people are becoming more reluctant to purchase big-ticket items?*

A That is probably true, particularly during this current situation. You know, the war-induced, pent-up

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demand for these items has been over for some time. So people are likely to put off buying a car or a major appliance until they feel a little safer about the status of their incomes for the next two or three years.

Q *Does this apply to furniture sales as well?*

A I would say so, particularly where major purchases are concerned. Also, there is bound to be a correlation between sales of furniture and appliances, and the purchase of new homes. Now, during this current recession there has been a marked dip in new housing starts. This was bound to have an effect on furniture and appliance sales. We aren't going to sell as many refrigerators, washing machines and home furnishings when the new housing market is sluggish. All these factors work together to affect retail sales adversely.

Factors influencing profits

Q *Mr. Straus, we hear a great deal about a profit squeeze that generally characterizes the business conditions of today. What has been the postwar ratio of profits to gross sales in the department store industry?*

A The ratio of profits to gross sales has been a fluctuating one since 1947. From 1947 through 1953 the range was fairly wide, fluctuating from a low of 4.7 per cent to a high of 7.3 per cent, before taxes. From 1954 on, however, the fluctuations have kept within a narrow range, between 5.6 per cent to 6.1 per cent.

Q *Would you say that there has been a profit squeeze on department store operations?*

A Naturally we are always under pressure from one source or another. In this business, as in any other, if you fall asleep, your profits will disappear and eventually you go out of business. There always are many influences at work on our profit situation, and we have to take steps to offset them whenever they affect us adversely.

Q *What are some of these influences?*

A Sales are a major influence on profits. A larger volume of sales usually means more profits. The period between 1946 and 1948, for example, brought a big increase in sales. Goods that were in short supply during the war were coming back on the shelves again, and people were eager and able to buy them. There was another spurt of buying during the Korean war period, particularly during the first few months when people were fearful that the wartime shortages would recur. Since then there have been no substantial fluctuations of the kind induced by fears of impending shortages. In any event, in our business the one way to maintain a healthy ratio between profits and sales is to maintain a high volume of sales.

Q *Isn't it possible that you can attain an increasing sales volume and still experience a drop in profits?*

A Very possible, indeed, especially during a period of steadily rising costs. I said sales volume was a major influence on profits, and certainly one way you can

offset the influence of rising costs, to a degree at least, is by increasing your sales volume. But volume alone isn't the whole story. The degree of our efficiency of operation and what is happening to our labor costs are also important influences on profits.

Q *What about labor costs?*

A Well, the answer there is pretty much the same throughout the economy. Such costs are going up, not only for us but for our suppliers as well. Adjustments have to be made to meet those costs. Some of these adjustments are reflected in higher prices. This is not always the inevitable solution, and, of course, we try to make our adjustments in as many other places as possible before we decide whether a price increase is necessary.

Q *How many of these adjustments can be made by increasing efficiency? Retailing is not generally credited with increasing productivity as much as, for example, the production industries.*

A When you start talking about productivity in retailing, you have to be careful about the type of retailing you are considering. In the grocery field, for example, the development of so-called supermarkets has considerably increased productivity. Goods are placed on open shelves or in bins, and what a grocery store clerk used to do for each customer is now done by the customer herself. Self-selection has revolutionized the operations of retail grocery outlets. The whole thing has turned out to be more satisfactory to the customer and less costly in terms of handling to the store operator. For a number of reasons department stores have not thought it desirable to employ supermarket techniques, except for a certain limited category of merchandise where some modifications have been used. Thus, a major breakthrough in marketing techniques has not been feasible for department stores.

Limitations to increasing efficiency

Q *Why haven't the department stores pursued the supermarket techniques?*

A I think you have to consider the nature of a business when you think about ways to increase efficiency. Mechanization and automation have been heavy contributors to an increasing productivity in the mass production industries. Such developments, on a similar scale, are not feasible in retailing. Similarly, the self-service principle has been a major contributor to increasing productivity in supermarkets. The department store, however, is a different type of business. The paying customers of a department store have a certain image of this business, and we feel that the image must be protected if we are to stay in business. Customers expect to enjoy certain privileges when they shop in a department store. They expect a wide variety of goods and a larger assortment than can be found in other retail outlets. They expect to be able to return purchased items, they expect delivery and they expect the services of a sales force. As long as people want and expect these things, we cannot operate like a supermarket. It would be suicidal to do so.

Q *Does this mean that there is no room for improvement in the operations of a department store?*

A No, that would be carrying the argument too far. I am suggesting that the scope of possibilities open to department stores is smaller than has traditionally been the case with our production industries and, more recently, with food and grocery stores. We are constantly looking for ways to improve our retail operations. For example, some of our departments, right here at Macy's, have been completely redesigned to encourage self-selection. The customer can do his own picking and choosing of some items, although a sales clerk is still available to answer questions, assist in selection and complete the sale. The layout of fixtures and display cases is constantly under study. Some efficiencies can be attained through such methods, but this hardly constitutes a marketing revolution.

The public expects certain services

Q *Why not allow the customer to do his own picking and then check him out as he leaves the store?*

A Well, first of all, we feel that the check-out system, which works so well in the supermarkets, is not feasible in a department store operation. And, secondly, we simply cannot dispense with the various services that customers have come to expect of us and will continue to get as long as they are willing to pay for them. This matter of what the public expects of a store is extremely important. A customer expects a great deal of service in a specialty store and very little at a discount store. A department store like Macy's is a sort of halfway house between the two. How much efficiency can be introduced into the operations of each of these businesses depends upon the degree of flexibility available to each type of operation. It is our view that people do not want to buy through mechanical gadgets in a department store. We are sure of our methods today, and changes, if any, will have to come slowly and only after long periods of experimentation.

Q *There has been no automation at the selling end?*

A That's right. We are introducing more self-selection, but no automation to speak of.

Q *How about the nonselling side?*

A There we have made substantial improvements. Most recently we have installed an NCR 304, an electronic machine that will handle all of our accounts receivable more accurately and faster than was previously possible. We have been using a UNIVAC for our accounts payable for some five years. All sorts of mechanical aids are in use in the handling, receiving, storing and delivering of goods. So I would say that, in the nonselling end of the department store business the increases in productivity have been quite notable.

Q *Mr. Straus, what has been the effect of the increasing number of so-called discount stores?*

A This is a very interesting question from a purely economic standpoint. I believe there is a place for discount stores just as there is a place for department

stores. Obviously the public thinks so also. As to what effect the competition from discount stores has had on department store sales, I don't know the precise figures offhand. There is no doubt that discount stores have forced department stores to re-evaluate their handling and pricing of certain merchandise. There is also no doubt that the department stores have decided not to meet discount competition in ways that would substantially alter the basic character of a department store business.

Discount houses and department stores

Q *You use the word "re-evaluate." In what way have discount stores forced a re-evaluation?*

A Well, department stores have taken steps to meet the competition of discount stores, but how competitive we could be depends upon how much latitude the customer gives us. We can afford to dispense with the delivery charge, if the customer does not want us to deliver. But we cannot afford to dispense with the services of a sales clerk, because the customer expects such a service. Also, it is expected that a department store will provide repair services if an appliance should prove defective or in need of repairs. All these are extra services that the customer expects from a department store. On the basis of what each type of store actually offers the customer, I would say that department stores generally are competitive with discount stores.

Q *Doesn't the customer expect the same services from a discount store as from a department store?*

A Obviously not. If he expected to get the same things from discount stores, their prices would be no lower than ours. That is why I say there is room for both discount stores and department stores. How well we do relative to each other depends entirely on the customer at the time and point when the customer decides to buy.

Q *Doesn't the mere fact that discount stores got started in the first place indicate that there was need for a type of merchandising that the department stores were unable or unwilling to undertake?*

A This is somewhat doubtful. Discount stores got started during a period when the maintenance of fair trade prices was being pursued by some manufacturers on a discriminatory basis. For example, department stores were being compelled by some companies to maintain manufacturers' list prices, even while retail discount outlets were being supplied with fair traded items to sell at considerably less than list prices. Now, don't get me wrong. I have already stated that there may well be a place for both types of retailing. But it is worth remembering that there are good reasons why discount stores can sometimes undersell a department store with some items. We all work under the same economic laws. The more services we render, the higher our costs will be. The public gets what it is willing to pay for. The old adage that the consumer is king is particularly true in the retail business. The department stores retail in a way that the consumers would like to see us retail, and the discount stores for their part will

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do whatever the public deems is acceptable in that type of retailing.

Q *Do you expect more or less competition from discount stores in the future?*

A That is hard to say. This much is clear now. Discount stores will have to depend largely on merchandising identifiable goods—that is, national brands. That is the one sure way that a customer can tell whether he is really getting a bargain. This is a limiting factor. Also, there is a tendency on the part of so-called discount stores to become more and more like department stores, to render more and more services. This adds substantially to their costs, which is reflected in their prices. When that happens, competition begins to take on a broader meaning than mere price competition.

Suburbs vs. the city

Q *Mr. Straus, Macy's is advertised as "The World's Largest Store." I suppose there is no arguing the point that a store like Macy's could be possible only in a city with one of the world's largest concentrations of population. What has the tremendous exodus to the suburbs done to the future prospects of Macy's?*

A I expect that in answering that question we shall have to talk as much about the future of cities as about the future of department store retailing in cities. A metropolitan center like New York City has traditionally supported a number of large department stores, not just Macy's. These department stores were attracting people from the area outside of New York City proper for a good many years before the great postwar rush to the suburbs. So, from the point of view of a department store located in the city, it is essential that New York City remain a great population center and that it continue to attract people from outside the city because of its many cultural and commercial services.

Q *Isn't it true that New York City itself has not increased its population as much as it might have, because of the tremendous growth of the suburbs?*

A Yes, of course, that is true. On the other hand, New York City has not ceased to grow and it certainly has not started to get smaller. What this means, in effect, is that established, alert and competitive department stores are not finding themselves with an excess capacity because of the move to the suburbs. In fact, even with the slowed pace of growth of population in the city, there is the prospect of continued increases in department store sales. This increase would have been greater if the exodus to the suburbs had not taken place. But that is another story.

Q *But the suburban development did take place, and*

it shows signs of continuing for some time to come. This certainly has represented a net loss to the city department store, has it not?

A In that sense, yes. For example, during the past five years, some three million square feet of department store space have been built in Nassau and Westchester counties in New York, and Bergen County in New Jersey. These relatively new department store operations represent a minimum of about \$150 million of department store sales annually. Much of this money would have been spent in New York City department stores if those branch stores had not existed.

Q *Will there be more branch stores?*

A Yes. As new population centers develop, we anticipate going to those locations where we think there will be an adequate number of potential customers. And Macy's competitors will do the same thing. The automobile is without a doubt a central feature of a suburban shopping center development. People in the suburbs prefer, quite naturally, to get to our branch stores in 15 or 20 minutes, park their cars in the substantial parking lots provided, do their shopping and be on their way home in the same amount of time that it might take to get to New York City. So there is no question about the convenience of branch stores in the suburbs.

Q *Are the suburban stores becoming absolute substitutes for the main city stores?*

A That depends on what you are shopping for. Branch stores are convenient, but they cannot hope to have as large an assortment of goods as the parent stores. Our largest unit in Long Island has 340,000 square feet. But Macy's in Manhattan has 2,100,000 square feet. This means that a customer looking for a particular item that isn't available at the moment in a branch store will likely find it in the main store.

Q *So it is possible to get customers from the suburbs to come back to the main store.*

A Of course. And this brings us to a consideration of the future of the city itself. The continued prosperity of an urban center depends upon the ease with which people can get in and out of the core city. It is in this "core" that the large department stores are located. A store like Macy's will continue to get customers from the suburbs until such time as transportation in and out of the city becomes impossible. Of course, we hope that that time never comes.

The transportation problem

Q *What is your assessment of the transportation situation in and around New York City?*

A Well, New York City has a good mass transportation system. Our subways and bus lines can bring anyone living within New York City to the "core" with relative ease. By comparison, a city like Los Angeles, for example, has no mass transportation system to speak

of. But automobile transportation has its problems. The highways leading in and out of New York City are good. North and south traffic within the city is also good, although the crosstown flow leaves a great deal to be desired. But adequate and inexpensive off-street parking facilities at the periphery or in the "core" are nonexistent. There is no doubt that this is a deterring factor insofar as attracting more people from the suburbs is concerned.

Q *Mr. Straus, one cannot help being impressed by the size and scope of operations of a store like Macy's. And when you talk about the increasing number of branch stores, one wonders whether the growth of national department store organization represents an undue concentration of power in the hands of a few over the retail field. Would there be any grounds for such thoughts?*

A There is a fancy word—"oligopolistic"—that describes a development like that. Are you asking whether there is an oligopolistic tendency in retailing?

Q *Yes. What percentage of retail sales is achieved through the large department stores that have branches in several large cities and suburbs?*

A Well, the term oligopolistic is used to describe a situation in which there are very few sellers. The implication is that these few sellers can therefore control the prices of the products they sell.

How competitive is retailing?

Q *It is possible, is it not, that even a few large sellers can control the major portion of the market?*

A Yes, I suppose that is possible. But this is hardly applicable to retail trade, which in 1958 had almost 1.8 million separate retail establishments. These establishments had a total sales volume of about \$199.6 billion. Of this amount, about \$46.4 billion of retail sales were garnered by the general merchandise, apparel, furniture and appliance, and mail order categories of retailing. The department stores are represented somewhere in that \$46.4-billion figure.

Q *How much of that figure is represented by sales of the large department stores?*

A Remember now that we are talking about the possible concentration of market power in the hands of the large stores. The \$46.4-billion figure represents all sales, by large and small stores, of a category of goods carried by department stores, as well. Still, \$46.4 billion is only 23 per cent of the total retail trade. Now we must establish how much of this is represented by sales of large stores only. The most feasible way to get that figure is to look at the sales of the 10 national department store organizations which, of course, include all of the stores of R. H. Macy & Co. These 10 store organizations had a sales volume totaling \$3.65 billion, or less than eight per cent of the general merchandise, apparel, furniture and appliance, and mail order categories.

Q *You speak of 10 department store organizations. Are*

Sears Roebuck and Montgomery Ward included among these?

A No. The 10 store organizations are Federated, Allied, May, Macy's, Gimbel's, City Stores, Associated Dry Goods, Marshall Field, Mercantile and Interstate. But let us include the ones you mentioned. I have the figures here. The 1958 sales of Sears came to \$3.7 billion, more than the 10 national department stores combined. J. C. Penney had sales of \$1.3 billion and Montgomery Ward \$1.1 billion. Now, if we add these figures to the \$3.65 billion of the national department stores, we get a total of \$9.8 billion. This total is still only 21 per cent of the sales by mail and across the counter of goods that department stores generally carry, and less than five per cent of the total retail trade of the nation.

Q *It would seem, then, that the so-called large department stores and their branches would have to do a great deal more expanding before the word "oligopolistic" could be applied to them.*

A I think we can safely say that in the retail field oligopolistic practices are extremely unlikely. I have done a little research, and I find that the 10 department store chains did about 1.8 per cent of the total retail business in 1958. That is the last year for which I have complete figures, and I doubt very much that the situation has changed much during the past couple of years.

Q *Is there something in the nature of retailing that discourages concentration?*

A I certainly believe there is, but I would put the emphasis on the forces in retailing that encourage diffusion, the opposite of concentration. Retailing will always be a highly competitive business because there is no limit to the number of ways that goods may be sold and because there are limitless numbers of ways to meet the needs of buyers. It is in the psychology of our people to go into business if there appears a likelihood of success. Our economic system encourages this type of outlook.

Q *In other words, a man isn't afraid to start off in business, even if he can't start with something as large as Macy's.*

A That's right, and Macy's wasn't always as large as it is today. I have an amusing story to tell you in this regard. There is a little store in the town where I live during the summer, and I go there every once in a while. Whenever I do, the owner and I exchange the usual pleasantries. I dropped in one day with a friend of mine, and while the owner was waiting on us, I happened to ask him, "How's business?" His response was, "My business is all right, Mr. Straus. How's yours?"

Q *Just like that?*

A Just like that. After we had left the store, my friend observed: "You know, he thinks he is just as important a businessman as you are, except that you have a better location." I think that story sums up the prevailing attitude about retailing.

Q *Yes, I think it does. Thank you Mr. Straus.*

CHALLENGE NOTES

Sidelights on the passing economic scene

PERQUISITE IN PURPLE—An estimated 10 per cent of the scientists and engineers engaged in research and development in industry will switch jobs this year, according to *The Wall Street Journal*. As part of its attempt to reduce this expensive turnover, one well-known firm recently moved its supervisory engineers out of cramped cubicles into air-conditioned offices decorated to suit each man's taste. One supervisor's office was painted purple.

► *Success colors a man's outlook.*

THROUGH CHANNELS—Top management isn't very effective at communicating, it appears. A survey of 100 companies made by the Savage-Lewis Corp. of Minneapolis showed that vice presidents understood only 67 per cent of messages from boards of directors or



top management. General managers understood even less—56 per cent. Plant managers grasped 40 per cent of the message and foremen absorbed 30 per cent of it. A mere 20 per cent of the original message finally filtered through to the workers.

► *What's that again?*

DEPRESSION, KEEP AWAY FROM MY DOOR!—Recently, Rep. Katharine St. George of Tuxedo Park, N. Y., stated that "there is no depression." There is an unemployment problem, she said, "because of automation." This problem, she said, "isn't as bad as we've been told."

► *How many unemployed in Tuxedo Park?*

EVERY MAN HAS GOT HIS PRICE—It used to be said that the chemicals contained in a human body were worth 98 cents. But now someone at Du Pont has come up with another figure. He asserts that the atoms in our bodies contain potential energy of more than 11 million kilowatt-hours per pound.

This would make the average man worth about \$85 billion.

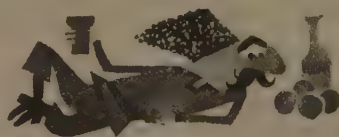
► *A new type of population explosion?*

IN THE RED—*Business Week* reports that a collection agency in Sao Paulo, Brazil, dresses its collectors in red—from hat to shoes. Thus, when a collector calls on a delinquent debtor, all the neighbors know what he is about. A second call is usually not necessary.

DO-IT-YOURSELF—A "Home-a-Minute" kit is available for those who are thinking of buying, building or remodeling a home. The kit contains partitions, doors, windows, cabinets, all made to the same one-quarter-inch scale as blueprints. Included is a 65-page handbook to help you become your own contractor. You can live in your new home before you actually build it. Only \$3.95 plus 50 cents postage.

► *Then you spend an additional \$40,000 and, presto! your home is complete.*

BITTER FRUIT—In the last six years Soviet imports from Greece have increased from six per cent of all Greek exports to 34 per cent. One reason for the increase is that Greece is not a member of the European Common Market, where most of her citrus fruits were



formerly sold. Now nearly 75 per cent of all Greek orange exports go behind the Iron Curtain. Commenting on the situation, a Greek official said, "We have reached the point where oranges are a factor in the cold war."

► *Has the squeeze replaced the pinch in the cold war?*

DISSENT DOWN-UNDER—"Joining the World Bank Will Mean National Slavery" declared a headline in *Liberator*, a New Zealand publication.

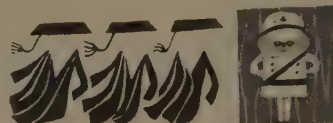
► *No need to contribute that much!*

DIVIDENDS FROM UNREST—"This has been a very troubled year," Edmund Warner, President of the Lake Erie Chemical Co. of Cleveland, said recently, "One of the best we have ever had." His company exports tear gas to 45 countries for use by riot squads.

PRICKLY PACKAGE—Part of the American Viscose Corporation's recent campaign to promote its synthetic fibers included the mailing of cacti to 2,000 converters, cutters and retail store executives. The plants emphasized the idea that some fabrics are stiff and prickly, while American Viscose's provide "real comfort."

► *Did they get the point?*

TRADE BARRIER FALLS—British Guiana has exempted academic robes, gowns and other academic dress from import duties. Academic robes of any



university, educational institution or professional body, approved by the Director of Education, that are imported by a graduate or member of such organizations are included.

► *An academic freedom not likely to be abused.*

NOTE FOR BIRDWATCHERS—The editor of *Audubon Magazine* has announced that the magazine will expand its non-bird departments.

► *So it can no longer be accused of being "for the birds"?*

SIGN OF THE TIMES?—A Charge Accounts Anonymous has sprung up in California. The purpose of the organization is to help those afflicted with the irresistible urge to run up charge accounts. When the urge to buy comes on, all a member has to do is dial the number of a fellow addict and talk it over.

► *How do they deal with the urge to pay?*

WHAT'S IN A NAME?—A plant that manufactures firearms in Springfield, Mass., is known as the Savage Arms Corp. . . . A packaging firm in Flushing, N. Y., is called Wrapture, Inc. . . . Dermot A. Dollar is the manager of a sales administration unit for RCA.

Is 'Fiscal Irresponsibility' the Answer?

by ROBERT J. ALEXANDER

■ SINCE THE NEW Administration in Washington is launching a greatly expanded program of aid to Latin America, economic policies below the border are of increasing interest to us. Many Latin American nations have been afflicted by rampant inflation, radically unbalanced budgets and recurrent balance of payments crises. These symptoms of economic disorder have given rise to a great deal of controversy, both in the United States and in Latin America, concerning the so-called "fiscal irresponsibility" of the governments involved.

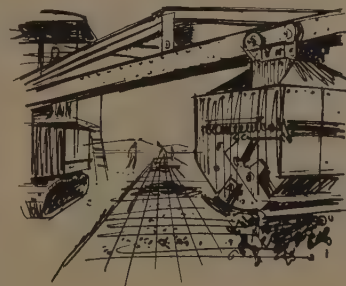
Latin American regimes accused of this "fiscal irresponsibility" in pursuing economic development have been roundly condemned by U.S. government officials and economists, as well as by spokesmen of international lending and financial agencies. President Kennedy, himself, when he called last March for a "vast new 10-year plan for the Americas," stated that its success would depend, in part, on monetary stability.

As a result of such criticisms and of their own experiences, several Latin American nations have undertaken extensive stabilization programs. But other Latin American governments have refused to do so and have strongly defended themselves against charges of "irresponsibility." They argue that economic development is achieved faster through inflation and unbalanced budgets, and that this environment encourages new industries and social groups at the expense of less active economic elements.

Opinion is, in fact, divided on whether there is justification for the supposedly irresponsible policies which have been so widely followed in Latin America. One thing is certain: severe inflation has become a problem in much of Latin America.

In Brazil, for example, during most of the years between World War II and 1958, prices went up by about 20 per cent per year. In 1959, as a result of the construction of the new capital at Brasilia and other government projects, prices mounted by approximately 60 per cent in that one year; in 1960 the increase was 40 per cent.

Argentina has also experienced considerable inflation. The process began during the latter years of the Peron administration; prices rose steadily between 1949 and 1955. After Peron's overthrow, the process was intensified, and in 1959 prices rose by approximately 100 per cent. At the end of that year, however,



Argentina launched a program of economic stabilization, and the pace of inflation declined dramatically.

Chile has also experienced a severe inflation since World War II. It was particularly rapid in the early 1950s, and in 1955 prices increased by 93 per cent. Since then several attempts to achieve stabilization have slowed the pace of inflation. By 1960 price increases had almost halted.

Bolivia is the Latin American country which has suffered the most drastic inflation recently. Between 1945 and the end of 1951 the average

rate of price increases in the capital, La Paz, was 18.5 per cent a year. Between 1952 and 1956 the average rose to 147 per cent a year. The stabilization program begun at the end of 1956 reduced this pace, and by 1960 the increase in prices was relatively slow.

Many factors have contributed to Latin America's economic and financial headaches. Certainly, a basic force has been the ardent desire of the Latin Americans to achieve the most rapid economic development possible. Since World War I most politically conscious Latin Americans have become convinced that their nations need to diversify their economies and, in particular, to develop manufacturing industries. They have learned that economies depending on the export of a very small number of commodities to pay for needed manufactured imports operate under distinct disadvantages.

This dependence meant that Latin American countries were unable to obtain the goods they needed from abroad during both world wars and the Great Depression. In addition, the prices of mineral and agricultural exports have tended to vary suddenly and sometimes extremely, thus making many Latin American economies highly unstable.

Growing nationalism has intensified the support for economic development and independence. An economically diversified country, not being dependent on a few major exports, is less subject to politically inspired economic pressures from major powers.

Under these circumstances, there is a great head of steam behind the desire for economic growth. Many of the expenditures which have helped to unbalance Latin American budgets are made for economic development. Furthermore, increased

demands for capital goods imports have exerted constant pressure on the balance of payments.

Since 1955 the pressure on Latin America has been intensified by a general fall in the prices of its export products. The terms of trade, which had been reasonably favorable since World War II, turned against the Latin Americans. As a result, between 1955 and 1959, income from exports in Latin America as a whole fell approximately 10 per cent.

This fall in export prices has had a catastrophic impact. The rate of economic growth was slowed. At the same time, the population of the region continued to increase at a rapid rate. As a result, the per capita rate of growth fell from 2.7 per cent to one per cent.

Problem of corruption

There are other factors besides the desire for economic development that tend to encourage "fiscal irresponsibility" on the part of Latin American governments. These factors include corruption, excessive military expenditures, inefficient operation of certain government enterprises and the flight of capital.

Corruption has been a major problem in recent decades. In some countries it has been worse than in others

ican countries have been deprived of large amounts of foreign exchange which might have been used to buy goods needed for economic development.

Military expenditures have been another serious drag upon Latin American resources, although the threat of immediate attack from outside the hemisphere has long been virtually nonexistent and the Inter-American System has tended in recent decades to reduce to a minimum the dangers of war among the Latin American nations. Nevertheless, most military budgets in Latin America account for between 20 and 50 per cent of total government expenditures. Argentina, Brazil, Chile, Peru and Venezuela are among the countries which regularly allocate between 25 and 30 per cent of their government budgets to the military. Several regimes also secretly spend large additional sums on their armed forces.

These military expenditures seldom aid economic development. Sometimes the engineering corps and a few other technical branches of the armed forces are used for constructive economic purposes. But military expenditures divert resources which might otherwise be devoted to promoting economic

growth. They are a major factor contributing to unbalanced budgets and, since they involve the importation of much military hardware, intensify foreign exchange shortages.

In some countries certain government-operated enterprises are another source of considerable waste. The enterprise itself may not be justifiable economically or it may be inefficient, or both. An outstanding example of inefficiency is the operation of the Argentine railroads, which have suffered sizable deficits ever since they were taken over by the Peron government in the late

1940s. In recent years they have accounted for a large part of the deficit spending by the Argentine government.

Another source of waste in the Latin American economies is capital that flees abroad. Tens of millions of dollars a year are invested by Latin American citizens and residents in other continents while their own countries are desperately short of investment capital.

Some of these funds spirited abroad are, as has been seen, the proceeds of corruption. Other fleeing capital belongs to businessmen who feel that their money would be safer abroad than at home. There is no doubt that the political instability of most Latin American countries has contributed to this situation.

Slow agricultural growth

There is at least one other major cause of inflation in many of the Latin American nations. This is the slow rate of agricultural growth. In some countries, notably Argentina, a marked decline in agricultural exports has intensified the foreign exchange crisis. In others, such as Chile, Brazil and Venezuela, deficiencies in agriculture have brought about a sizable national demand for imported agricultural products.

The causes of this situation vary from one country to another. However, in almost all of them it is partly attributable to the rapid increase of population and of urban demand for agricultural products. In most of the nations it is also due to failure to apply modern methods to farming or to invest enough in agricultural equipment.

An outmoded landholding system persists in most of Latin America. Most of the land remains in the hands of small oligarchic groups and is cultivated by tenants who work under semifeudal conditions. Latin American landlords of the traditional type pay little or nothing in wages under this system and generally receive an acceptable income from cultivating only a relatively small part of their holdings. As a result, they have little incentive to employ modern methods or to make full use of their land.

Thus, a formidable list of problems faces the Latin American economies. It is not surprising that



—perhaps it has been most serious in Brazil, Mexico, Cuba, Venezuela and Argentina. Untold millions of dollars have been siphoned out of government budgets and national economies by government officials and political favorites. Internal financial resources which might have been used for economic development have been diverted to private pocketbooks.

A large part of these ill-gotten gains have found their way abroad. They have been deposited in U.S. or Swiss banks, or invested in foreign enterprises and government securities. As a result, the Latin Amer-

ican countries have been deprived of large amounts of foreign exchange which might have been used to buy goods needed for economic development.

Military expenditures have been another serious drag upon Latin American resources, although the threat of immediate attack from outside the hemisphere has long been virtually nonexistent and the Inter-American System has tended in recent decades to reduce to a minimum the dangers of war among the Latin American nations. Nevertheless, most military budgets in Latin America account for between 20 and 50 per cent of total government expenditures. Argentina, Brazil, Chile, Peru and Venezuela are among the countries which regularly allocate between 25 and 30 per cent of their government budgets to the military. Several regimes also secretly spend large additional sums on their armed forces.

measures to deal with these complex issues have aroused considerable controversy, nor that inflation itself has had many adverse effects on economic development. Since inflation leads to general instability, some entrepreneurs who might otherwise make useful investments are discouraged. Inflation also results in social injustice, making those elements in society which are least able to afford it pay for economic growth and development. As a result, it leads to a high degree of social unrest that intensifies the political instability already widespread in many Latin

countries. Such instability is a major hindrance to economic growth. American countries. These "irresponsible" policies and the resultant inflation can also be seen. Inflation tends to induce the Latin American governments to maintain exchange controls, embargoes and other interferences with trade. Both inflation and these regulations tend to stimulate profiteering and corruption, especially in the administration of controls.

However, there is a strong school of thought in Latin America, supported by at least some North American economists, which defends inflation. Adherents of this school point out that, whatever the drawbacks, inflation and "irresponsible" government financial policies *do* bring about economic growth. Under such conditions, a domestic market for a country's products tends to be assured. Also, investment tends to be encouraged, for even relatively inefficient firms can make a profit when prices constantly rise. This situation results in high returns for the owners of new industries, who are the principal group in Latin America ploughing back profits into investment and economic expansion.

The defenders of "fiscal irresponsibility" also point out that unbalanced budgets permit the Latin American governments to mobilize resources for development projects which they deem essential. They can spend the funds necessary for such projects without the political opposition which an equivalent amount of taxation would arouse. Such deficit financing may perhaps be compared with the United States government's policy of mobilizing the resources necessary to fight World War II in large part by borrowing instead of by taxation.

In recent years there have been



numerous cases of both "responsible" and "irresponsible" handling of fiscal matters by Latin American governments. The experiences of Argentina and Brazil can serve to assess the pros and cons of both methods.

Argentina underwent a decade of inflation from the late 1940s until 1958. The value of the Argentine peso slid disastrously, falling as low as 100 to one U.S. dollar. At the end of 1958, Arturo Frondizi's government undertook to apply a policy of economic stabilization and "sound finance." This called for freezing wages, freeing prices, establishing a single exchange rate for the peso, considerably liberalizing foreign trade, liquidating a number of government-owned enterprises and encouraging heavy foreign investment, particularly in the petroleum industry.

This program has had notable effects. The foreign exchange value of the peso has leveled off at approximately 80 to the dollar. The increase in the general price level has slowed down and has almost ceased. In two years the country has become self-sufficient in oil, thereby saving some \$300 million a year in imports. During this period Argentina has attracted a considerable amount of new foreign investment in a wide

range of industries, including chemicals, automobiles and steel.

On the negative side, however, this Argentine stabilization program has resulted in a sharp fall in general purchasing power. In 1960 there was a decline in the gross national product. A number of industrial concerns have been forced into bankruptcy. Many others are working part time. As a result, the country is faced with mounting unemployment. Furthermore, the stabilization program has created a degree of political tension and disillusionment in the country's political leaders which is very dangerous for the future of democracy in Argentina.

The second case is that of Brazil. In that country there has been an unbroken history of inflation since the early 1930s. By the late 1950s the people had come to regard a 20 per cent increase in the general price level each year as "normal." The structure of wages is geared to this process; both general minimum wage levels and wages in particular industries have been periodically and regularly increased to keep pace with the rise in prices.

Shortage of foreign exchange

In Brazil inflation has been accompanied by a chronic shortage of foreign exchange. Periodic foreign exchange crises have occurred. During these crises the country would have had to suspend payment on its foreign commercial debt if help had not been provided from abroad. The foreign exchange situation became particularly acute under President Kubitschek. During his administration (1955-60) the price of Brazil's principal export, coffee, declined sharply; at the same time, Kubitschek's development program required substantial imports, thereby putting special pressure on the country's foreign exchange situation.

The Brazilian case involved all of the evils which are usually associated with inflation. Corruption has been notorious. Social unrest has been very extensive and, though usually just below the surface, has frequently broken into the open.

In spite of very heavy pressure from the United States government, the International Monetary Fund and many elements within the country, the Brazilian government has so

far refused to undertake a drastic stabilization program. There have been some indications, however, that President Quadros intends to take certain important steps, such as making an attack on corruption and discharging surplus civil servants. But it remains to be seen whether he intends to employ far-reaching measures such as the Frondizi regime used to halt inflation in Argentina.

Brazilian government leaders have argued that inflation and unbalanced budgets, in spite of accompanying evils, have brought rapid economic growth to the country. They point to the building of Brasilia, the opening up of new regions in the interior, the establishment of new steel industries, the rapid growth of the chemical and auto industries, the construction of new roads and the expansion of the country's electric power resources. These accomplishments, they claim, demonstrate the success of their method of handling fiscal and economic issues.

Certainly, the experiences of Latin America with policies of "fiscal ir-

responsibility" do not clearly demonstrate that these policies are *really* irresponsible. Unbalanced budgets and inflation, it is true, are not the prescriptions of orthodox economics and public finance. However, it is by no means clear that such unorthodox economic policies are bad for the achievement of the basic economic objectives of the Latin American governments—as rapid a development as possible. Inflation and unbalanced budgets are one method of obtaining such growth; it remains to be proved that a policy of drastic action to achieve balanced budgets and stable internal prices can bring about fast economic development.

Another important consideration is the impact of stabilization programs on politics. If such programs result in a slowing down of the rate of growth, they are likely to cause political unrest. If a large number of people are hurt economically in the short run by a stabilization program, then antidemocratic forces will be able to win greater public support.

As we have noted, government expenditures on economic development are not the only cause of inflation and unbalanced budgets. Indisputably, there are measures which could reduce the extent of both of these without resorting to the Spartan measures used by Argentina since 1958. Military expenditures could be reduced. There could be changes in agrarian policy. These should include land redistribution, an increase of capital investment in agriculture and the spread of new techniques; in addition, more investment should be channeled into transportation to connect rural areas with urban markets. There is little doubt that such actions would reduce the extent of inflation while, at the same time, stimulating economic growth.

In formulating United States policy toward Latin America, it would be wise to weigh all the foregoing considerations. We wish to promote the well-being of the Latin American republics. Let us be sure that we advocate a course of action that will do so. ■

The limits of monetary and fiscal policy

Needed: A Cure that Fits the Disease

by **PATRICK M. BOARMAN**

■ AS THE NEW Administration attempts to implement its economic programs, it is becoming increasingly fashionable to attack the present independent role of the Federal Reserve System. Critics of the Fed's role say that the executive branch should not be hampered in the fulfillment of its pledges to the electorate by the efforts of a "fourth branch of government" (the Fed) to hold the price level stable.

The national interest, so the argument continues, requires that the Fed be absorbed into the executive branch, as is the case in other West-

ern parliamentary democracies, or, at least, be made responsible to the executive. It is said that only in this way will it be possible to develop a coherent and effective blueprint for national economic management.

This argument has a certain persuasiveness, but only if one accepts its fundamental assumptions. The first of these assumptions is that monetary policy, fiscal policy and Treasury borrowing policy are the principal instruments available to achieve the goals of price stability, rapid economic growth and high employment. Monetary policy, which

has to do with interest rates and the amount of credit, is administered by the Federal Reserve. Fiscal policy (taxes and expenditures) is controlled by Congress, while borrowing policy is handled by the Treasury.

A second assumption is that the possibility of realizing stability, rapid economic growth and high employment simultaneously is exceedingly slight. The nation, we are told, is faced with a "cruel choice." It can have full employment and a high rate of growth at the cost of some inflation. Alternatively, it can have price stability at the cost of unemployment and a slow rate of growth. If this is the case, an administration that directs the Fed's policies can select the compromise between some inflation and some unemployment which it thinks would best serve the national interest.

But are these assumptions valid? Is it not risky to advocate pushing the whole task of providing the conditions for adequate stabilization and growth onto governmental shoulders? An important point is all too frequently forgotten: there may

be substantial structural (nonmonetary) factors operating in the economy which may bring about unemployment and diminished rates of growth *regardless* of changes in monetary and fiscal policy.

Concentration of power

A principal obstacle to stabilization via monetary and/or fiscal policy is the concentration of economic power in the hands of big labor and big business in key industries. Inflation caused by an agreement between labor and management to raise both wages and prices is possible only within such a context. Consequently, the Fed finds itself in a dilemma. It may "cooperate" with this inflationary wage-price spiral by allowing the quantity of credit to increase to cover this price rise. Or it may restrain credit, thereby exposing itself to criticism for having encouraged a decline of demand and employment in the economy as a whole.

There are convincing reasons for believing that monetary and fiscal controls will be effective in dampening a boom or in overcoming a recession only where the economy has (a) a substantial degree of competition and (b) a stable consumption function—i.e., the proportion of income devoted to consumption and savings remains comparatively constant.

But in our modern "affluent society" it is questionable whether the consumption function is as stable as it has been assumed to be. There is reason to believe that money does not move through the economic system today in a constant and predictable manner. One indication of this is that despite inflationary pressures in late 1958 and 1959, important segments of the economy remained in the doldrums. The automobile industry is one of the most striking examples.

The decline of competition in the automobile industry may well be one of the most significant factors behind its relative stagnation. This industry has become increasingly oligopolistic—that is, a few corporations dominate the industry. This does not exclude such firms from engaging in fierce "rivalry" with one another. Notwithstanding, oligopolistic producers seem unable to adjust speedi-

ly to changes in demand—in this case, the shift in consumer preference from big cars to compacts.

This can be explained, in part, by the fact that oligopolists are less likely to be *aware* of shifts in consumer preferences. For it is a fact, familiar to students of communications theory, that the amount and the accuracy of the information which can be transmitted over a channel will increase as the number of *possible* messages that may be sent increases.

It is in this sense that competition (number of firms) may affect the

ing pattern of consumer desires. Cumulative consumer frustration resulting from the decline in the number of alternative varieties of automobiles available may lead to "explosive situations." Such an "explosion" recently led to a slump of sales of domestic cars and a sharp rise in the imports of foreign cars.

The international implications of declining American competitiveness become clear when we recall that during the period in which the range of choice offered by automobile producers in the United States was rapidly shrinking, the opposite was



volume and the correctness of the information transmitted from the demand to the supply sides of the market. When, as the result of the existence of many firms in an industry, consumers are offered a wide choice of products, producers are likely to be better informed about the underlying drift of consumer desires and to avoid major investment mistakes in trying to meet them.

In telegraphy the sending of the letter A achieves its meaning in part because B, C, D, etc., have *not* been sent. So, too, the selection by consumers of a message (the purchase of a product) to be sent to producers achieves its meaning by virtue of the number of possible choices that are rejected. In an oligopolistic market, consumers are compelled to buy one of the restricted choices offered or to refrain from buying altogether. Consequently, the amount of information which they can transmit to producers about their demands is severely limited.

It is probably not an exaggeration to say that the number of firms in the automobile industry has been so reduced as to render the producers increasingly insensitive to the chang-

taking place in Europe. After World War II the European automobile industry entered a period of unprecedented expansion. The many firms in the industry brought out a sometimes bewildering but also fascinating collection of vehicles: from tiny Isettas and Goggomobiles to luxurious Rolls-Royce and Mercedes-300 limousines.

Differences in the assortment offered by American producers were, on the contrary, relatively minor. Not only were the differences between the models of a single producer increasingly difficult to distinguish (due to the use of fewer body types in an effort to achieve greater economies of scale), but it became more difficult to see differences among the models of various firms. Oligopoly seemed to be leading to the elimination not only of price competition but of quality competition and product variation as well.

Thus, the European producers were in a position to satisfy not only almost all of the differentiated demand of the European market, but also in increasing degree the requirements of the American market. As a result, American producers lost in a

relatively short time significant segments of their foreign as well as their domestic markets.

In spite of substantial reductions in the Fed's rediscount rate, the lowering of reserve requirements and accelerated governmental outlays—all of which helped to spark a boom in most other branches of American industry—the decline in the automobile industry was unusually long and deep. The purchasing power was there, but the products and prices were "wrong" in the judgment of a considerable number of buyers. In fact, the domestic demand for American automobiles stagnated over a long enough period (1957-59) to give rise to the suspicion that the situation in the American automobile industry had aggravated, if not in part caused, the general economic recession.

A recession, once precipitated, may be made worse by the action—or more accurately the inaction—of monopolistic or oligopolistic producers. Such producers are still in the dark as far as knowing what consumers want. Moreover, to the consumer's existing dissatisfaction with the available set of products will be added the depression-caused psychological resistance to all purchases, except of essentials.

In such an atmosphere, the oligopolistic producers, with their high break-even points, will be hesitant about assuming the innovational risks needed to re-establish contact with consumer demand. In a more competitive industry, on the other hand, innovation is more likely to be undertaken since, for enterprises which hold only small shares of the total market, product experimentation is less risky than it is for a member of an oligopoly.

Excessive concentration of industry, in other words, has a tendency to cause short circuits in the economy's communications system. Because of this, an economy which is deficient in competition is likely to be (a) more susceptible to a crisis and (b) less able to recover once a crisis has developed.

The long-delayed introduction of the American compact car has, it is true, tended to alleviate the effects indicated above. But this innovation provides no guarantee that the American automobile industry, giv-

ing in its present degree of concentration, will be any better able in the future to predict and to adjust to new shifts in demand.

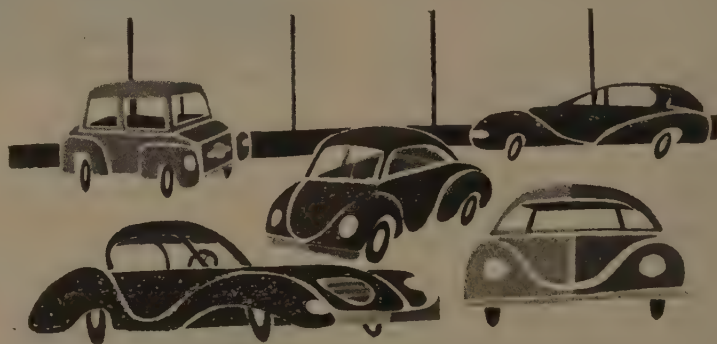
The relative decline of American product competitiveness and the domestic inflation of costs and prices have also had a significant influence upon the allocation of American private capital. This capital is currently flowing out of the country in massive amounts in search of more promising opportunities abroad.

Of itself, of course, the export of capital from a capital-rich country like the United States ought not to be a cause of concern. Such outflow will tend to provide the giver with sources of future income, and also to increase the general productivity of the recipient countries. But there is evidence to indicate that a significant share of the present outflow of capital is taking place not only in order to sell in foreign markets but

because it aggravates the current drain on our gold reserves but because it tends to reduce *domestic employment*. Capital and labor are complementary factors of production. A sufficiently large export of capital occurring in a sufficiently short time can cause unemployment of significant quantities of labor in the capital-exporting country. Moreover, the structural alterations necessary to provide new job opportunities for these unemployed may be costly and time-consuming.

Easy money policy?

This seems to be a problem which is hardly amenable to solution by strictly monetary means. Will an easy money policy on the part of the Fed be able to cope with this structural displacement of labor? What seems more probable is that easy money will provoke a rise in the cost of living. This will trigger a rise in



also to repenetrate the domestic market with goods produced more cheaply than at home.

In short, some of the capital outflow is certainly traceable to continued toleration of inflation and industrial concentration in the United States. This is a process which can hardly be viewed as unqualifiedly good, even in the long run. It is one which tends to depress the U.S. economy in relation to the world economy in the same way that the movement of capital facilities from West Virginia and Detroit to other parts of the country tends to transform these areas into pockets of depression.

The export of private capital may prove to be embarrassing not only

wages which will, in turn, cause a further outflow of long-term capital.

The power of labor unions and business enterprises to maneuver themselves pricewise and product-wise out of markets is now great enough, it seems, to throw the whole economy into a recessionary slide. In the oligopolistic sectors of the economy, market forces no longer serve their theoretical purpose of adapting supply to demand; it is now demand which must adjust to rigid prices and rigid products. More and more frequently of late, the adjustment has tended to be a downward one with the result that output and employment have also moved downward. In sum, price inflexibility and product inflexibility yield that disturbing

phenomenon of our time—unemployment with *inflation* rather than *deflation*.

This phenomenon emerges in part because the economy is not one in which "pure competition" reigns everywhere. Indeed, in many areas there is little or no competition. The U.S. economy of the Sixties obviously cannot—nor should it—conform to some theoretical model of pure competition. Nevertheless, our system does require a substantial amount of competition if the traditional devices of money and fiscal policy are to serve their avowed purposes.

Product homogeneity

Pure competition requires product homogeneity and a sufficient number of firms within an industry to reduce the market power of any one of them to insignificance. By any reasonable concept of welfare, the existence of pure competition in the industrial sector of the economy would not be a good thing. Competition should not be so "pure" as to prevent a desirable and even necessary degree of product variety within an industry nor the exploitation of reasonable economies of scale.

On the other hand, neither should competition become so "impure"—that is, oligopolistic or monopolistic—in the pursuit of economies of scale that product variety is again seriously diminished. For the effect of this will be to reduce the ability of the system to adjust in response to consumer demand without the hesitations which, when cumulative, may generate a cyclical downturn.

Indeed, given the growing importance of discretionary income and "deferrable" purchases in the American economy, the ability of the economy to grow may depend very much on its ability to produce the right product at the right price at the right time. It may further depend upon the avoidance of inflation. Even in its creeping form inflation tends to distort investment decisions (thus laying the groundwork for eventual cutbacks in investment activity).

In addition, as George Katona of the Survey Research Center, University of Michigan, has shown in his provocative psychological studies of the American economy, inflation tends at times to have adverse effects

on consumer psychology, creating a general unwillingness to buy because prices are rising.

The economy's ability to pump out an ever greater quantity of goods and services or to constantly increase output per man-hour will be of little use if the output is not *fully saleable*. A point generally ignored in the hubbub about growth is that one economy may grow faster than another, not because it is richer or technologically more advanced, but simply because the variety of prices and products it can offer is continuously more attractive than that offered by other countries.

There seems to be something of an anomaly in the fact that the currently stagnating American economy suffers from a deficit in its balance of payments while the booming, fully employed West German economy has a surplus. Past experience and theory would have led us to expect the opposite: the expanding economy to show a deficit in its balance of payments, the contracting one a surplus.

The present curious international juxtaposition of surpluses and deficits is due to the interaction in the world market of two divergent economies—the increasingly competitive, monetarily disciplined economy of Western Europe (and more specifically of West Germany) and the increasingly less competitive, monetarily less disciplined economy of the United States. Indications are growing that a booming domestic economy will tend to have a booming export trade, and that the same factors which make for a slack or declining economy at home will cause a deterioration in a country's export capabilities as well.

The experience of West Germany provides a striking example of how a judicious mixture of tax policy, wage policy, market structure policy, and fiscal and monetary policy can bring about high levels of employment and fast rates of growth with relative price stability. The law which created the German central bank establishes the independence of the bank and indeed sets forth as one of its fundamental duties the defense of the purchasing power of the mark. Almost all European central banks, it may be added, today regard inflation as *the enemy*.

Thus, the assumption that the

Federal Reserve System, with its independence and its antipathy to permanent cheap-money policies, is an anomaly in respect to the rest of the world is simply not borne out by the facts. Obviously, a central bank need not oppose the executive arm of government as a matter of principle simply because it is independent. Specifically, the central bank of Germany (Bundesbank) is charged with the responsibility of coordinating its actions with those of the administration in power *insofar as this is compatible with its primary objectives*.

Fast-moving science

If the Germans can have their cake and eat it too, why can't we? Certainly we ought to pay some attention to the peculiar combination of policies—the fostering of competition, incentive taxation and monetary discipline—which Germany has adopted to provide her with a fast-growing, fully employed, recession-free economic system. This might prove distasteful for it would force us to change some rather deeply ingrained economic ideas. But economics is a fast-moving science. As the orthodoxies of the classical period proved unsuited to the problems of the Thirties, so too the orthodoxies which have crystallized out of the experience of the Thirties may no longer be adequate to deal with the problems of the Sixties.

In fact, monetary and fiscal controls are losing much of their former effectiveness due to the relative decline of competition in the United States in certain important labor and product markets. Thus, there is reason to feel skeptical about the purposes to be served by the proposal to make the Fed subservient to the executive branch of the government. Moreover, it is far from certain that the Fed's present interest in preserving the stable dollar is necessarily incompatible with sound growth and high employment.

If, in truth, we are presently faced with a dilemma of having to choose between some inflation or some unemployment, this is not a situation which must be accepted as a kind of unalterable fact of nature. Surely, the way to resolve this dilemma is to restore a greater degree of competitiveness to the economy. ■

HOW LONG CAN MOSCOW CALL THE TUNE?

by **ALEXANDER ECKSTEIN**

■ MANY PEOPLE have perhaps wondered, as they read of the recent ideological conflicts between the Soviets and the Chinese Communists, why it is that the Kremlin, so far at least, has seemed to hold the upper hand. The explanation lies largely in the realm of economics. This becomes clear when one considers the importance of Soviet trade and aid to Communist China's economic development.

To understand the present Sino-Soviet economic relationship, we need to examine the changes that have occurred in China's economy since the Communists came to power in 1949. The Chinese Communists inherited an economy devastated by years of war—the Sino-Japanese conflict, World War II and civil war. Manufacturing capacity had been further curtailed by the dismantling of industrial plants in Manchuria by the Soviets during 1945.

As a result, industrial production was at about 25 per cent of its prewar level when the Communists took over. Railroad transport had been so thoroughly disrupted that even the few goods that were produced could be brought to market only with great difficulty. Agricultural production stood at 75 per cent of its prewar level.

Therefore, the first task of the Chinese Communists faced was to restore the economy to working order. This they essentially accomplished within three years. At the same time, they began to subject the economy to thoroughgoing control, thus making it more responsive to their objectives. With this in mind, they embarked upon a program of land reform designed to break the political

and economic power of the landlord class.

Beginning in 1953 they embarked upon their drive for rapid and forced-draft industrialization within the context of a Five-Year Plan. This drive continued under a second Five-Year Plan (1958-62). In order to industrialize quickly, particularly amidst rapid population growth, consumption per head had to be kept in check. For this purpose, rationing was introduced in 1953. Meanwhile, in agriculture, the development of cooperative and collective farms was pushed.

In effect, as soon as the peasants received the land, it was taken away from them. Chinese Communist planners were anxious to prevent the peasants from consolidating their new gains; at the same time they wanted to make sure that the state obtained control over most of the agricultural output. This farm output could then support an expanding labor force and could also provide more exports to finance the imports of equipment and raw materials essential for industrialization.

"Great leap forward"

By 1957 most business enterprises were publicly owned and operated, and almost all farms were collectivized. However, even this rapid pace of transformation was not sufficient to satisfy the ambitions of an impatient Chinese Communist leadership. Thus, the "great leap forward" was launched in 1958. The communes were designed as a prime instrument for mobilizing and controlling surplus and underutilized labor. The planners hoped, through the mass application of labor in agricul-

ture and industry, to double output within a year, even though they had to rely on quite primitive methods.

As a result of this decade-long outpouring of effort, the economy of China has made great strides toward industrialization. In many ways the performance has been a truly impressive one. National income has been growing at an average annual rate of about six to seven per cent—roughly twice the speed at which the U.S. economy has been expanding.

Of course, not all sectors of the economy grew at the same rate. Expansion was most rapid in the basic and heavy industries, which were accorded the highest priority. This segment of industry grew at a spectacular average rate of 25 to 30 per cent a year between 1952 and 1959. The consumer goods industries expanded about one-third as fast, but still somewhat faster than the economy as a whole. Agriculture, on the other hand, lagged badly, growing at a rate of about three to four per cent per year.

The Chinese Communists, then, like the Soviets earlier, concentrated on the development of heavy industry at the expense of agriculture. Therefore, food production just barely kept ahead of population growth. This created severe strains and acute shortages, particularly in poor harvest years such as last year. In spite of this, the Communist leaders have relentlessly pursued their central objective—the rapid generation and augmentation of China's power. They have succeeded admirably, as illustrated by the fact that between 1952 and 1959 steel production rose tenfold, electric power generation sixfold, coal production fivefold and cement production fourfold.

In a large country such as China, international trade is necessarily small in relation to the product and income of the economy as a whole. Therefore, in recent years, exports and imports constituted no more than about five and six per cent, respectively, of gross national product.

Accelerated pace

However, this small segment of the economy has played a decisive role in launching China on the road to industrialization. Traditionally, for most countries, imports serve as the principal highway for the introduc-

tion of new technology, new know-how and innovating influences in general. Perhaps even more important, through imports, underdeveloped countries such as China can obtain machinery, equipment and industrial raw materials which cannot be produced at home.

This process has proceeded at an accelerated pace in China during the past decade. For instance, according to official Chinese Communist pronouncements, 40 per cent of the machinery and plant installations for the first Five-Year Plan (1953-57) had to be imported. In addition, China was heavily dependent upon imports for steel and petroleum.

In China's case this dependence on imports for industrialization meant dependence upon the Soviet Union and the rest of the Communist bloc. Trade controls imposed by the U.S. and its allies, following China's entrance into the Korean war, precluded purchase from the West of a wide variety of items needed for industrialization.

As a result, about 70 to 75 per cent of Communist China's foreign trade is with the Soviet bloc—roughly 50 per cent with the Soviet Union and 20 to 25 per cent with Eastern Europe. The Soviet bloc's share in China's trade rose from less than 30 per cent in 1950 to a peak of more than 80 per cent in 1955. Since then, partly due to a relaxation of trade controls and partly due to a Chinese drive for closer economic ties with uncommitted nations, commercial exchanges with countries outside the bloc have been growing in importance.

Cumulative excess

Between 1950 and 1959 total Sino-Soviet trade grew from about \$580 million to \$2,055 million. During the first part of the decade, the Soviets exported much more to China than they imported from her; by the end of 1955 this cumulative excess amounted to almost \$1 billion. But this trend was radically reversed in 1956, and by 1960 China had compensated the Soviet Union for almost two-thirds of the earlier export surplus.

Except for 1957 and 1958, China was the Soviet Union's leading trading partner during all these years. However, while half of China's for-

ign trade was oriented around Russia, only one-sixth to one-fifth of Soviet commerce was with China. Therefore, in these terms at least, China was much more dependent on the Soviets than vice versa.

The commodity composition of this trade reinforces this conclusion. Machinery, industrial equipment of all kinds, petroleum and petroleum products constituted the staples of Chinese imports. Conversely, Chinese exports to the Soviet Union con-



sisted of agricultural products, non-ferrous metals and textiles. China was thus procuring from the Soviet Union the very essentials of industrialization. On the other hand, the Soviets bought from China mainly consumer goods which they easily could have obtained in other markets.

In our view, government grants—i.e., free gifts or loans—constitute economic aid. However, the Soviets regard all shipments from Russia to China, and all kinds of technical assistance rendered by Russians in China, as aid, regardless of how it is financed. These differences in the definition of "aid" have tended to create an exaggerated impression of the extent of Soviet economic aid to China.

Under six separate agreements concluded between 1950 and 1959, the Soviet Union obligated itself to "help China in the construction of 291 large-scale projects." Well over half of these projects involved the construction and installation of entire new plants. Close to a quarter represented new additions to exist-

ing plants, and the remainder involved the modernization of existing plants.

These more or less complete plant deliveries represent "aid" to China only in the sense that they constitute critical and absolutely essential contributions to the Five-Year Plans. Frequently, the impression is created that the Chinese do not have to pay for these shipments of complete plants and that they constitute aid over and above the officially announced Soviet loans. This view is not supported by the facts. Shipment of complete plants is simply a form of Soviet exports to China. These plants are paid for partly out of Soviet loans and partly out of China's exports to Russia.

None of this is meant to minimize the importance of the services rendered by the Russians to the development of the Chinese economy. What is being stressed is that these services are not free—they are paid for. At the same time, the Soviet Union seems to have gone out of its way to satisfy Chinese industrial requirements. This is illustrated by the fact that Soviet exports of machinery and equipment grew from 11 per cent of total deliveries to China in 1950 to 60 per cent in 1959.

In recent years this type of export to China exceeded in quantity and value similar Soviet deliveries to all other countries combined. It is for this reason that, in the Soviet and Chinese official view, these exports represent economic aid, even though they are paid for by the Chinese. It would be "aid" in our sense of the word only if the Soviets subsidized these exports by not charging the Chinese the full domestic or world price, or if these deliveries forced Soviet planners to reduce the rate of their own country's industrial expansion. However, on the basis of presently available evidence, this does not seem to have been the case.

The costs of technical assistance rendered by the Soviets have also been paid by the Chinese. According to Chou En-lai, about 11,000 Soviet experts have worked in China during the past decade. In addition, 7,100 Chinese technicians were trained in Soviet industrial enterprises and 6,500 Chinese students attended Russian universities. The Chinese financed this assistance through ex-

port earnings and loans obtained from Russia.

The exact total of Soviet loans to China is difficult to determine because of inconsistent statements by the governments involved. It seems, however, that Soviet credits to China—during an eight-year period ending in 1957 when all credits were exhausted—amounted to about \$1.3 billion. This is an average of about \$160 million annually. While far from negligible, this sum is less than the annual amount of U.S. economic aid to India in recent years. Such a comparison can naturally be misleading since much depends on how foreign aid is used. The Chinese Communists channel it almost exclusively into expansion of industrial capacity while other countries may use much of it for financing consumption.

Trade, not aid

Soviet credits added only about one per cent to aggregate domestic output in China from 1950 to 1957. But the bulk of the credits financed deliveries of investment goods. As a result, Soviet credits may have raised the levels of investment in China by about five to 10 per cent.

These credits imposed practically no drain on the Soviet economy since they represented less than one-tenth of one per cent of Soviet national product between 1950 and 1955. Even if one assumed that they diverted funds that would otherwise have been used for investments in the Soviet Union, the drain would still be no more than four-tenths of one per cent of total investment.

This analysis of the Sino-Soviet economic relationship clearly shows that Soviet trade, not Soviet aid, made a decisive contribution to Communist China's industrialization during the past decade. It also demonstrates that Sino-Soviet trade is of much greater importance to China than it is to Russia. Thus, in economic terms, China is much more dependent on the Soviet Union than vice versa.

Does the Soviet Union exploit its dominant position? All the available evidence would suggest that Sino-Soviet commercial transactions are based on world market prices, with some deviations for individual commodities. The possibility of exploita-

tion cannot be completely ruled out, but until we know at what prices the commodities imported from the Soviet Union are accounted for in the Chinese trade statistics (which are not published), we can only speculate on this question.

If the Soviets are not exploiting the Chinese, are they perhaps granting them unusually favorable terms of trade?

The answer to this question is a most complicated one, since it depends on what assumptions one makes about the priorities in Soviet planning. Up to Stalin's death the Soviet Union was committed to a pattern of development centered almost exclusively around heavy industry at the expense of the consumer and of the agricultural sector. Within this context, large-scale export of machinery and equipment in exchange for consumer goods could be viewed as a sacrifice of Soviet industrial expansion for the sake of China's industrialization.

In fact, however, between 1950



and 1958, such exports could have reduced Soviet investment in machinery and equipment by no more than one or two per cent. Yet, in Stalinist terms, even such a small reduction might be viewed as a major sacrifice. If planners attach such a high value to machinery and such a low value to consumer goods, they are justified in charging high prices for their equipment exports while paying low prices for consumer imports. If one assumes that this is still the prevalent system of values in Russia, one could conclude that the Russians regard trading with the

Chinese at world market prices as a subsidization of the economy of Communist China.

But this line of reasoning does not seem to accord with realities in the Soviet Union since 1953. While the Soviets still assign highest priority to the development of heavy industry, they have in recent years paid much more attention to agriculture and to the consumer. Real wages and household incomes in the Soviet Union have risen steadily since 1953. This shift in emphasis means that trade with China can be quite advantageous to the Soviet Union. Consumer goods imports from China enable the Soviets to increase consumption faster than domestic production facilities would permit. Moreover, the more Russia can import these goods, the less she has to divert her resources to producing them.

Sino-Soviet trade can be considered as "natural" from another point of view as well. It is probable that Russia has a comparative advantage at her present stage of development when she exports industrial equipment and raw materials and imports agricultural products. Climatic and soil conditions place severe limits upon the further expansion of Soviet agriculture, so that the current Sino-Soviet trade pattern is likely to continue for some time to come.

All these considerations make it seem that Sino-Soviet trade yields certain benefits—at a certain cost—to both sides. But given the underdeveloped state of her economy, China is much more dependent than Russia upon imports for her economic development. At the same time, precisely because China's income and output per head is so low, exports in payment for imports involve greater sacrifices for China than they would for a more developed country. Therefore, both the gains and the costs of Sino-Soviet economic relations are much greater for China than for Russia.

Not free of strain

This economic partnership is by no means free of strains. There are constant irritants and frictions. In recent years China's balance of payments has been greatly strained, principally because she has had to sustain a sizable export surplus in her trade with Russia in order to

repay Soviet loans. Since 1956 this excess of exports averaged around \$150 million per year.

If this quantity of exports could have been used to purchase additional machinery and equipment, the level of investment in China could perhaps have been raised by about 10 per cent. Moreover, this repayment obligation increased the pressure on Chinese agriculture to deliver more and more of its product to the state. At the same time, China's ability to export to other markets has been limited. Moreover, during these same years, the Soviet Union has extended foreign aid to a number of countries outside the bloc. It would be surprising, indeed, if the Chinese Communists did not feel aggrieved at not having received any credits, much less grants, since 1957, while they have had to meet such heavy repayment obligations.

There are, however, possible causes for complaint from a Soviet point of view as well. While the Chinese have concluded long-term trade agreements with most of the Soviets' East European satellites, they have consistently refused to do so with the Soviet Union. Chinese export capabilities and import requirements vary from year to year because of marked fluctuations in harvests. For this reason, China wishes to preserve flexibility and freedom of action in her foreign trade. The Soviets, on the other hand, are unhappy about filling sizable orders for equipment and machinery without firm long-term commitments from the Chinese.

For the time being, the Chinese are economically still quite dependent on the Soviet Union. As long as the U.S. and its allies restrict trade with China, she will have to place her orders for industrial equipment and raw materials with the Soviet bloc. Therefore, it can be assumed that the Chinese may be perfectly willing to put up with minor frictions as long as their present relationship with Russia continues to yield the economic benefits it has in the past.

On the other hand, the Soviet Union enjoys a superior bargaining power in the partnership, since Sino-Soviet trade is of much less importance to the Kremlin than it is to Peiping. In the past, Russia has apparently not employed this bargain-

ing power to gain any overwhelming economic advantage over China, but she may well have applied it in political and ideological negotiations.

As long as the Soviet Union enjoys primacy in the Communist bloc she can limit Communist China's ability to pursue an independent policy. Nevertheless, this situation is subject to rapid change. It is clear already that, as the Chinese have gained military and economic strength, the ten-

sions in the Sino-Soviet alliance have mounted. This process can be expected to continue without producing a break in the alliance. Perhaps the maximum chance for such a break will come at a time when Chinese economic and military strength closely approximates that of the Soviets, or, what is more likely to occur sooner, when the present political and economic isolation of China comes to an end. ■

The stock market and the economy

Wall Street Jumps the Gun

by **RICHARD E. LOW**

■ SINCE THE great crash of 1929, the stock market has shown a peculiar tendency to run ahead of the economy, with market upturns and downturns taking place several months before those of the general economy. Even as early as the recession or depression of 1937-38, the market turned down two months before the economy did and hit its low point three months before the economy finally turned upward.

Since World War II this tendency has been even more pronounced. The exact dates concerned, it is true, can differ depending upon what stock index is used. For instance, the traditional Dow-Jones average of only 30 high-grade industrial stocks sometimes has different turning points from those of the Standard & Poor's index of 425 industrials. The exact months in which the economy has turned are also open to some question, although the months used by the highly respected National Bureau of Economic Research are widely accepted—and are used in this article. But these variations do not change the basic patterns.

In the first postwar recession of 1948, the market turned in June (both Dow-Jones and Standard & Poor's indexes). But the economy hit

its high point (Democratic interpretation) or recoiled in dismay (Republican view) in November, the month in which Harry Truman was re-elected. In that recession the economy hit bottom in October, 1949, five months after the market had turned up the previous May.

The next major market downturn came in January, 1953, with the economy belatedly following in July. Eisenhower prosperity started upward in August, 1954, although the Eisenhower market had turned upward as early as September, 1953 (Standard & Poor's), or January, 1954 (Dow-Jones).

The start of the 1957-58 recession is the only exception to this sequence since World War II. The economy and the market turned down together in July, 1957. The market, however, turned up first—in October (Dow-Jones) or February, 1958 (Standard & Poor's)—with the economy following in April.

In the present recession the market turned down in January, 1960, and the economy in May. The market started to turn up last October, while the date of the economic upturn is still being debated as this is written.

To sum up, in the eight major

economic turns since World War II, the market led the economy in seven and coincided with it in one. In none did the economy lead the market. This is in striking contrast to the situation in 1929 when the market crashed in October, several months after the economy started to decline. It is probably also in striking contrast to previous crashes, but the data available for earlier periods are sketchy.

Accurate predictions

The market's general habit of turning *before* the economy is usually attributed to increasingly accurate predictions. As economic forecasting improves, the argument runs, the market is more and more able to outguess the economy and to call the ups and downs in anticipation of change, rather than just responding to it.

As is widely known, pension funds, mutual funds and trust funds are growing quickly. Financial institutions, including the funds, accounted for 24.3 per cent of the transactions on the New York Stock Exchange in September, 1960, according to a special study made by the Exchange. Market specialists concerned with maintaining orderly markets in particular stocks accounted for another 13.6 per cent.

The funds can afford to retain professional investment consultants and, indeed, cannot afford not to do so. These experts have at their disposal voluminous research on business trends provided by the government and by many private research organizations. Because of their size, many funds are more influenced by general business conditions than are many small private investors, who are on the lookout for some particular stock in which to make a killing.

But even the individual investor, if he is interested (and he usually is), can get the results of much expert research and opinion inexpensively from the pages of *The Wall Street Journal* or *The New York Times*, as well as from many other sources—information that no amount of money could have obtained in the past.

With this multitude of investors receiving and following professional advice, the ability of the market to outguess the economy is limited only

by the skill of the experts and the information at their disposal. And, while the skill available may not have changed over the past century, the supply of information has skyrocketed. It is somewhat disappointing, therefore, to those who believe that the market lead is due primarily to accurate economic predictions that no such precise predictions immediately precede shifts in the market.

One reason the market tended to follow the economy in 1929 and before is that the market itself was then the best-known and most measurable indicator of business trends. Today the facts and figures collected by the National Bureau and other researchers are incredibly complete and complex. But past figures were so scanty that the facts on 19th-century cycles collected in this century by the National Bureau even include Queen Victoria's marriage as an event influencing economic trends.

Today, instead, we are surfeited with an embarrassment of statistical riches. The most important of these, from the viewpoint of economic forecasting, are what are known as the "leading" indicators—series that rise and fall before the general economy does. The stock market itself has now become one; others are residential building, new orders for durables, new incorporations, the average workweek, raw material prices, commercial and industrial building, and business failures.

Changes in these leading indicators and in others are widely publicized as soon as they are released. The simplest explanation of why the market leads the economy is that changes in these leading indicators cause institutional and other sophisticated investors to buy or sell in anticipation of the general economic changes thus foretold.

Unfortunately, this cause does not fully explain the effect. The most fundamental error is the assumption that the gathering and correlating of this information can be done in time to cause the result. So far, this has not usually been possible. Indeed, the only major leading indicator which is known immediately is the stock market itself, which can hardly cause its own turns—although it does, of course, accentuate them.

A possible explanation of this difficulty may lie in the special attention paid by the experts for the major funds to the major corporations whose stocks these funds own. Some leading indicators, not included in the list of the eight major ones given above, are closely connected to the factors that traditionally cause a rise or fall in the market. These leading indicators of corporate activities ("corporate leading indicators") include the value of new orders placed for plant and equipment, changes in business inventories, corporate profits per dollar of sales and corporate profits after taxes.

The experts for the funds may, therefore, get—by following closely the corporations in which they are interested—figures that give an early indication of impending trends. This would explain the market's lead over the economy better than an assumption of accurate, more general predictions—an assumption which may be true but cannot be shown to be so. Panic falls and sudden upswings have been noticeably absent from the postwar market. This moderation indicates that changes are today brought about by selective buying and selling rather than by general movements.

Growing fragmentation

Another reason for this discrepancy between the market and the economy may be the growing fragmentation of both. With increasing numbers of American industries becoming more immune to general economic conditions, or running counter to them, a powerful countercyclical influence has been added to both the market and the economy. Last fall the two major Presidential candidates took opposite sides on the question of whether the country was in a recession. Nothing could show more clearly how many Americans are so far removed from the effects of the business cycle than the fact that they did not know the answer from personal experience. This immunity is reflected in the market by the immunity of many stocks today, especially some growth ones, from these cyclical changes.

Other segments of the economy are not so much removed from the cycle as running counter to it. This is especially true of corporations—

such as defense contractors—affected by government anticyclical policies. Thus, many stocks rise on the market when the economy is falling, and vice versa, thereby helping to cause the market and the economy, at times, to go in different directions.

If the growing speed and accuracy of statistical forecasting has contributed to the market's lead over the economy, this lead could increase in the future. The accuracy of the sampling techniques upon which the series of leading indicators are based is constantly increasing. Figures will be reported more quickly and new computers should reduce the time needed to compile the results.

Even more important, new leading indicators are being developed that can be ascertained more rapidly. One of the most interesting of these is the indicator derived from job want ad totals, available the same day

improved forecasting. It is doubtful whether the day will ever come when the political "ins" can insure their re-election by inserting want ads in the papers the Sunday before election, but a growing degree of accuracy can cause very basic changes.

Serious attention has been given to the market lead so recently that no basic study has yet been made of its effects on the general economy. But several possibilities suggest themselves. As previously noted, one of these is the possibility that this lead can result, and perhaps has already resulted, in shortening the business cycle.

The fact that the market moves up while the economy is still declining, and vice versa, may also serve to moderate the business cycle. Some consumption, especially in middle income groups, may depend on the state of the market. This is especially



newspapers appear. So far these figures seem to be a highly accurate leading indicator, and they have the advantage of giving separate regional trends.

Both the economy and the market should react quickly to such indicators as soon as they win general acceptance. It may be, indeed, that one reason business cycles have grown shorter in duration since World War II is a quickening of business reaction to forecasting. If the time should come when these indicators are thought so accurate that a businessman, reading on Tuesday the result of the Sunday want ad computations, decides on that basis whether or not to hire another clerk, the economy will have caught up with itself; forecasting will have created its own immediate results.

Between the present uncertainty and such a high degree of certainty lies a wide range of possible future economic and market reactions to

true of purchases of luxuries by investors of limited means, who are encouraged to spend more on consumption when their stocks are rising.

Formerly it was thought that much investment depended on the ability of business to raise funds by floating stocks on a rising market. To the degree that this is still true, the fact that the market rises before the economy does could encourage the economic upturn.

Inventories are especially sensitive to business expectations and may, therefore, be especially influenced by the market lead. In the past, so large a part of short-term cycles was due to fluctuations in inventories that they were frequently referred to as inventory cycles. To the degree that a rising market may encourage business to expand its inventories before the economy turns up, and vice versa, the market lead may moderate cycles considerably.

The market lead may also influence countercyclical Federal Reserve policies, since the Federal Reserve has been traditionally responsive to market conditions. It may be significant that the Federal Reserve responded much more quickly to the 1960-61 recession than it did to the start of the 1957-58 one, the only case in postwar years in which the market did not lead the economy. Thus the market lead may result in quicker antirecession policies.

The four postwar recessions do not show any marked trend toward either a shortened or extended length of the market lead over the general economy. It might be thought that the lead would tend to become greater as forecasting becomes quicker and more accurate. But if the economy itself reacts to the improved forecasting, the lead may instead become shorter. We may even reach the day when businessmen, consumers and stockowners compete in the rapidity with which they apply the predictions of economic forecasting to their economic activities. This would affect the indicators themselves and give the economy the appearance of the rapid-fire movements of early motion pictures.

At one time, the market was viewed as nature was once viewed by primitive man—as a combination of overwhelming power and frightening irrationality. But when man learned that an eclipse of the sun was natural and temporary, an eclipse stopped affecting anything except the electric light bill.

In the same way, the market lead may be primarily a reflection of the growing human understanding and control of the forces that move the economy. In the days when economic statistics were not plentiful, market decisions tended to be short range and based in large part on wild fear or hope. Everyone knew his immediate situation; few knew enough about the forces shaping the future to base decisions on them. Today temporary eclipses can be seen for what they are. The factors that cause the sun to re-emerge are better understood, and more and more investors are concentrating on these factors instead of on the more dramatic but less basic economic movements of the immediate present. ■

Committee on Foreign Relations: **United States Foreign Policy**

abstracted by JAMES D. CALDERWOOD

■ ON JULY 31, 1958, the United States Senate authorized its Committee on Foreign Relations to make a complete study of U.S. foreign policy. The Committee then invited 12 private research organizations to prepare studies on various aspects of this subject. These 12 studies, together with a 13th by the staff of the Committee itself and a "Summary of the Views of Retired Foreign Service Officers," have now been published in a monumental two-volume work of 1,473 pages. The two volumes thoroughly survey the economic, political, military, scientific, ideological and administrative aspects of the current world situation and the role of the United States in it. (See "*The Scope of the Report*" on the opposite page.)

Four main themes run through this work. The first, as one would expect, concerns the challenge of the Soviet Union to the free world. As the opening sentence of Study No. 1 states: "The fundamental fact which dominates our foreign policy problems is the determined, relentless intention of the Soviet Union to control the world." This challenge is total in nature and embraces production, trade, science, the military, the arts, race relations, propaganda, diplomacy and politics—indeed, just about every field of human thought and action.

The second theme is the revolutionary developments occurring in the underdeveloped countries. Here the two great facts of life are poverty and nationalism, which make an extremely explosive combination. As Study No. 12 states: "The entire fabric of these societies . . . is being torn apart, the old and time-honored being replaced by totally new economic, political and social forms."

Abstracted from *United States Foreign Policy*, prepared under the direction of the Committee on Foreign Relations of the United States Senate, 86th Congress, 2nd Session, September, 1960.

Abstracts of significant, original research are prepared by leading scholars for publication in *CHALLENGE* at frequent intervals. They are presented as a public service in cooperation with the Joint Council on Economic Education.

The third theme is the revolutionary effects of science and technology on production, trade, communications, war and population growth. Already our world has been transformed by them, and even greater changes are likely in the future. Unfortunately, in the opinion of Study No. 2, "the outlook is that the progress of science and technology will do more to create or intensify than to ameliorate [foreign policy] problems, unless deliberate policy measures are taken."

Theme of response

The last theme is the vital one of the response of the American people to the dynamic and perilous developments of our times. This is considered at three levels. First is the question of the wisdom and intelligence needed to comprehend the nature of the world and to devise satisfactory approaches to world problems. Second is the problem of adjusting our political and administrative organization and procedures to these requirements. Third is the question of the national purpose. As Study No. 7 puts it: "Will the American people support the necessary policies at the cost of greater sacrifices to themselves? Do they have a

sense of great purpose, such as the Nation had at earlier critical periods of its history?"

The Soviet challenge is, as already noted, total in nature. A fundamental part of it is, of course, the military threat. The sobering statement is made in the report that "the military position of the United States has declined in the short span of 15 years from one of unchallenged security to that of a nation both open and vulnerable to direct and devastating attack." As long as the cold war continues, therefore, American foreign policy must be based on a defense policy designed to protect the free world from such a direct attack.

Nevertheless, since each of the superpowers has the ability to destroy the other, emphasis is now shifting to other forms of conflict. Of fundamental importance now is economic competition in the fields of growth and of trade and aid relations with the rest of the world, particularly the underdeveloped countries. The objective of the Soviet Union is to surpass the United States in industrial production, to make itself the world's number one economic power, and thus to demonstrate to the rest of the world that communism has the secret of efficient and speedy growth.

It is more meaningful to compare industrial production in the United States and the Soviet Union than gross national products; the industrial sinews, not the fat of consumer goods and services, are important in the power struggle. The estimates are that, during the 1950s, industrial production in the Soviet Union increased at an average annual rate of between nine and 10.5 per cent, while the figure for the United States was 3.5 per cent.

At present, industrial output in the Soviet Union is 40 to 45 per cent of ours. If present trends continue, the Soviets will surpass us in total industrial output in 15 to 20 years. But if the rate of growth in the United States can be accelerated, this fateful day will be postponed.

The growth of Soviet industrial power has three significant implications. The first is that the Soviet Union, with a GNP less than half of ours, is believed to be already spending the same amount as we for mili-

tary purposes. Any further industrial growth might permit them more easily to exceed our military expenditures and thus increase the threat to our security, as Study No. 11 points out.

On the other hand, a less pessimistic opinion is voiced in Study No. 6. This is that Soviet industrial growth is not of decisive importance in a military sense, "since a limited number of hydrogen bombs can create total destruction" and "the military problem is qualitative rather than quantitative."

The second implication of Soviet industrial growth, its "demonstration effect," is much less debatable, however. To the less developed countries the Soviet Union represents itself as having a system which can provide rapid economic growth. And this is something Asia, Africa and Latin America want more than almost anything else. As Study No. 6 puts it: "Time is of crucial importance. The poverty-stricken people of the world will not wait indefinitely. If existing non-Communist governments pro-

vide no relief, the desperate masses will turn to communism."

The third implication of Soviet industrial growth is that it will permit the U.S.S.R. to expand its trade and to provide foreign aid and technical assistance on an increasing scale. As a result, "countries heavily dependent on Soviet trade or loans may be subject to irresistible pressures to adopt policies insisted on by the U.S.S.R." Furthermore, the U.S.S.R.'s growing influence in underdeveloped countries may be used to mold their technology and their economic, social and political institutions in the Soviet pattern.

Complex and frustrating

The aspirations and policies of the less developed countries create some of the United States' most complex and frustrating problems. All over Asia, Africa and Latin America a great awakening is taking place; the peoples of these areas are beginning to demand the better life which they know modern technology makes possible. This "revolution of rising ex-

pectations" is sweeping the underdeveloped countries and transforming them economically, socially and politically.

As Study No. 13 puts it: "What we are seeing now in the Middle East are the first spasms of change as 6,000-year-old tribal-village structures begin to respond to the pressure of the discontented and the aspirant." And Study No. 5 states: "The traditional fabric of societies in Asia is rapidly disintegrating while the creation of viable nation-states is lagging behind. This discrepancy between social disintegration and reconstruction creates a crisis situation which has ramifications in all aspects of Asian life."

Along with this growing determination to overcome poverty on the part of the less developed nations is their intense nationalism. Countries which were either colonies or only nominally independent before World War II are now independent and members of the United Nations; they are speaking out in voices which command attention. The two great adversaries of the cold war both court these new nations which thus have greater political influence than might otherwise be the case.

The important point which must be understood by Americans is that there are two paths to growth available to the less developed countries. India is taking one; it is striving to industrialize and raise standards of living within a democratic framework. The other is the path followed by China—communism. The majority of the less developed countries, however, are still "uncommitted" in that they could still go either way. This is not to say that they are likely to make a deliberate decision, but rather that the forces of economics, politics and history may push them down either path.

The race between India and China to see which will grow more during the next decade is one of the most fateful in human history. The United States cannot afford to allow India to lose; yet during the 1950s China's industry appeared to have advanced more rapidly than India's.

The fate of the world may be determined in the next decades by events in the less developed countries. Clearly, the United States and other Western countries need to

THE SCOPE OF THE REPORT

FIVE of the report's 13 studies concern themselves with specific geographical areas. They are: No. 3 on Western Europe by the University of Pennsylvania's Foreign Policy Research Institute; No. 4 on Africa by Northwestern University's Program of African Studies; No. 5 on Asia by Conlon Associates, Ltd., of San Francisco; No. 11 on the U.S.S.R. and Eastern Europe by a joint faculty group of Columbia and Harvard Universities; and No. 13 on the Middle East by the staff of the Foreign Relations Committee itself. A sixth study, No. 12 by M.I.T.'s Center for International Studies, deals with the economic, social and political changes in underdeveloped areas in general.

The one major area not extensively covered in the two volumes is Latin America. This is presumably because the Foreign Relations Committee's Subcommittee on American Republics Affairs published six studies on U.S.-Latin American relations during 1959 and 1960.

Two of the studies in the current volumes are concerned with science and technology—No. 3 by the Stanford Research Institute on nonmilitary scientific developments and their impact on foreign policy, and No. 8 by the Johns Hopkins University Washington Center of Foreign Policy Research on military technology and its impact on foreign policy.

One study is primarily concerned with ideological factors (No. 10 by Harvard University's Center for International Affairs) and one is specifically on economic problems (No. 1 by the Corporation for Economic and Industrial Research, Inc.). As might be expected, however, economic affairs receive considerable emphasis throughout the work.

The administrative and operational aspects of foreign policy are dealt with in two of the studies—No. 6 by Syracuse University's Maxwell School of Citizenship and Public Affairs, entitled "The Operational Aspects of U.S. Foreign Policy," and No. 9 by the Brookings Institution, entitled "The Formulation and Administration of U.S. Foreign Policy." Finally, the "Basic Aims of U.S. Foreign Policy" are discussed in Study No. 7 by the Council on Foreign Relations.

make a much greater effort than they have done so far to help these nations make a breakthrough into sustained growth and become stable, progressive, democratic and truly independent.

Foreign policy problems

Scientific developments in the next decades will give rise to many new foreign policy problems and will also intensify existing ones. One consequence of new scientific developments is likely to be that existing forms of political organization will become increasingly outmoded. We are likely to see dramatic developments in such areas as the exploration of outer space, partial control over climates, the opening up of Antarctica and the exploitation of the virtually untapped resources of the oceans. In this respect, Study No. 2 notes: "Current concepts of national sovereignty are not well suited to the orderly regulation of these advances nor to their development for maximum utility with minimum effort. Policy planners will find it increasingly necessary to explore new types of supranational organization."

Advances in public health and medicine are likely to bring down death rates and thereby intensify the explosive growth of population in many parts of the world. This could lead to social unrest and even war. An important task ahead of us, then, will be to use our scientific knowledge in ways that will increase food output in areas of chronic need, for instance, through the control of photosynthesis and other new techniques as well as through existing ones.

In many areas, overpopulation is already acute and is likely to become worse. It is imperative to develop new methods of birth control, particularly a safe, effective and cheap oral contraceptive. Thus, science, which is helping create the overpopulation problem, can also contribute to its solution.

Scientific advances will also continue to give us new synthetic products which will increasingly displace natural products in world trade. Many of these natural products, such as rubber and various fibers, are the principal source of foreign exchange for less developed countries. Fundamental economic adjustments are

likely to become necessary in this area. It is unlikely that natural market forces can be relied on to bring about such adjustments smoothly and painlessly. We should, therefore, already be thinking in terms of international efforts to deal with these problems.

The report expresses concern over the fact that the present emphasis in scientific research and development in the United States and other countries is overwhelmingly on the needs of the military and industry. Since foreign policy problems are largely problems in human relations, it is important to allocate more effort and support to the psychological and social sciences.

The maximum degree of peril to the United States in the next decade is likely to occur as a result of rapid developments in military technology. It is pointed out that a "stable" re-



lationship between the United States and the Soviet Union exists in a military sense when circumstances and influences conducive to and favoring the initiation of total nuclear war are countered and outweighed by opposing factors. Such a stable relationship appears to exist today and is likely to continue during the next decade. This stability stems from the "balance of terror"—the fact that an aggressor would suffer retaliation that would inflict unprecedented destruction; therefore, aggression becomes an irrational act.

Dynamic situation

On the other hand, there are forces at work that can destroy this stability. The principal one, of course, is the highly dynamic situation with

respect to changes in military technology. Study No. 8 points out: "Progress in military technology will continue at an accelerating rate during the next decade, increasing both the performance of individual weapons systems and the number of weapons systems that it becomes feasible to develop." Thus, both the United States and the Soviet Union will have repeated chances to seize an important or even decisive lead in such areas as missiles and satellite space systems. In short, the decade of the 1960s promises to be one of uncertain peril.

Permanent "settlement" unlikely

This report contains many policy recommendations, both general and specific. The basic assumption underlying all of them is that, in the foreseeable future, a permanent "settlement" with the Soviet Union is unlikely. This is because the U.S.S.R. believes that history is on its side and that sooner or later, by one means or another, communism will triumph in the world. Another assumption is that, in spite of some problems and weaknesses, the position of Soviet leaders will remain strong and that they will continue to be committed to seek a Communist world. The general conclusion is that the United States will have to use a wide range of methods—military, political and economic—if it is to meet the Soviet challenge.

It is vital, first of all, that the United States not permit the military power of the Soviets to outstrip that of the free world. It is the military "standoff" that at present permits the use of such a wide range of methods in our foreign policy. Specifically, the following military objectives are stressed: the maintenance of a degree of retaliatory power sufficient to deter attack; the maintenance of mobile nonnuclear forces capable of dealing with "brush-fire" wars; the strengthening of our alliances, particularly NATO; and a research and development program that is capable of keeping us at least abreast of and, if possible, ahead of the Soviet Union.

Assuming that a degree of military security can be achieved and maintained, it then becomes vitally important that the United States adopt a positive approach in its foreign

policy. It should not merely be *against* Soviet aggression, but also for freedom and democratic progress. This country should have, as Study No. 7 points out, "a broad basic aim which responds to the deep aspirations of the world's peoples. . . . Such an aim is the building, jointly with other free nations, of a new international order. . . . For most peoples of the world today this is an age of change, of liberation, of promise and of hope." The United States needs to identify itself, and be identified with, these aspirations.

In no part of the world does this need to be accomplished more than in the less developed countries. The sense of this report is that a massive effort on the part of the United States and other Western countries is going to be necessary if the less developed countries are to make a breakthrough into sustained growth; moreover, the opinion is expressed that disaster may result if such a breakthrough is not achieved.

Growth with freedom

With regard to foreign aid, the report says that, "while the economic and technical assistance programs of the United States in the past have represented a partial recognition on our part of the nature of the problem, for the most part they have been a mixture of emergency measures, palliatives and efforts to strengthen our allies for purely military reasons." What is actually needed is a vast, cooperative, long-run program, imaginatively planned and executed along the lines of the Marshall Plan, and designed to launch the less developed areas on the course of growth with freedom.

Study No. 7 states that "there must be a movement of capital goods from the industrial to the less developed countries going well beyond the present volume; a massive effort to build up technical and administrative competence; action to correct or minimize the effects of drastic swings in the prices of certain basic commodities . . . and urgent planning on how to tackle the population problem in the areas of rapid growth before it reaches the proportions of disaster."

The point is frequently made that this program cannot be purely American. What is required is a cooperative effort by all the advanced in-



dustrial nations in partnership with the recipients. This calls for a tightening of bonds with our friends of the North Atlantic Community and greater use of international agencies and regional institutions.

The important point is also made that our aid to the less developed countries should not be exclusively material in nature. In addition, they need our sympathetic understanding and moral support. Above all they need to feel that we are equal partners with them in a great adventure of the human race whose ultimate goal is a better life for all.

Efficient and humane

Finally, the importance of certain domestic developments that affect our foreign policy is stressed. A key one is the rate of growth of the American economy. It is essential that we accelerate our rate of growth if we are to fulfill our foreign obligations, such as foreign aid; if we are to maintain the burden of necessary defense expenditures; and, above all, if we are to demonstrate to the world that a free society can be both efficient and humane. The report also states that "the national interest requires a more conscious direction of scientific activity in ways likely to assist in the achievement of America's international goals."

The report also considers the question of whether our political and administrative organization and procedures are as well suited as they might be to carry out the policy desired. The opinion is advanced that adjustments are needed to meet new requirements. A number of specific suggestions are made with respect to the role of Congress, the President,

the Secretary of State, the Department of Defense, the intelligence agencies and other agencies. For example, it is stated that there should be more emphasis on strong field organizations and less on minute supervision of foreign operations from Washington. The sense of these sections of the report is that much could be done to increase the effectiveness of the formulation and execution of United States foreign policy.

The opinion is also advanced that there has been too great a proliferation of specialized international bodies dealing with particular phases of development in the less developed areas. Instead, what are needed are integrated country programs with a country director having power to coordinate all developmental activities. The United States should provide vigorous leadership in the United Nations to achieve this.

The big question

The big unanswered question in this report concerns the American people. Are they so absorbed in maintaining and enjoying their own material well-being that they will not rise to the challenges of the next decade? Or will they support whatever measures are necessary to the foreign policy objectives desired? There are both optimistic and pessimistic signs here, but perhaps in the final analysis the outcome will depend on the quality of leadership in the United States. As Study No. 7 states, "The role of leadership under our democratic form of government can hardly be overemphasized."

A concluding quotation from the same study perhaps sums up the challenge ahead of us. "If the American people have shown a genius in their own history, it is in the development of political institutions balancing essential freedom and necessary authority, and in the creation of material wealth on a broad basis without coercion. Surely, if we can see the meaning of our national experience in relation to the broader and changing world scene, the goals for the future become clear. The basic challenge is whether we as a people can move toward them with the urgency, the vigor and the understanding of humanity's needs which are so obviously demanded by the times in which we live." ■



Import Liberalization and Employment. Walter S. Salant and Beatrice N. Vaccara. 380 pp. Washington: The Brookings Institution. \$6.75.

- Two contradictory liberal political absolutes—the virtues of full employment and of freer trade—collide head-on over our tariff policies. Their embarrassed exponents usually take refuge in the “long run.” But, as Lord Keynes remarked, “In the long run we will all be dead.”

Economists Salant and Vaccara give little relief in this thoughtful work to those who would pretend this contradiction does not exist. They analyze the possible effects of tariff cuts on employment from many viewpoints and in many industries, usually coming up with a net loss in employment.

This study could be a valuable aid in selecting which industries should lose tariff protection first, and the rate at which tariffs should be reduced. As the authors point out, normal job turnover provides leeway for a gradual tariff reduction without unemployment.

It is to be hoped that equally competent studies will be made on the effect of tariff reductions on national income, regional adjustments, investment, etc. (all treated only partially in this work), so that the program of freer trade now advocated in Washington can be carried out with a minimum of dislocation.

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France and the Economic Development of Europe, 1800-1914. Rondo E. Cameron. 586 pp. Princeton, N. J.: Princeton University Press. \$10.00.

- At the end of this monumental study of economic history, the author concludes: “Frenchmen contributed more, both directly and indirectly, to the material welfare of Europeans in the century after Waterloo than in all previous history; more, too, than has fallen to the lot of most nations in the span of human history.”

Cameron, Associate Professor of Economics and History at the University of Wisconsin, traces how France industrialized herself, following the British model; how she created a legal code

that facilitated economic growth; and how she developed her science, technology and professional schools. In turn, all these developments had an immense influence on other European countries.

French financiers pioneered in creating institutions, such as the *Crédit Mobilier*, that collected the capital needed for economic growth. Not only did the Rothschilds, the Pereires and other towering figures of French finance channel French funds into European investments, but their methods were copied by Dutchmen, Germans and others.

Perhaps because it was easiest to research, Cameron records the financial side of this French economic epic in immense detail. Sadly missing is the excitement of a saga of enterprise. Coal mines in Belgium and Germany, the new European zinc industry, railroads from Spain to Russia, bridges over the Danube—the creation of these and many other examples of vision, enterprise and skill are dryly recorded.

In conclusion, Cameron asks what lessons France's experience in aiding the industrialization of Europe holds for us today. He lists conditions needed for the export of capital to produce economic growth in receiving countries. Outstanding among these, he holds, are widespread literacy, a society that values growth and change, and agrarian reform.

• • •
A Short History of Technology. T. K. Derry and Trevor I. Williams. 782 pp. New York: Oxford University Press. \$8.50.

- “All that bewilderingly varied body of knowledge and devices by which man progressively masters his natural environment” is the subject of this book, which traces the development of technology from the Stone Age to the turn of the 20th century.

The authors have made a point of relating technological change to social, economic and political history. They point out, for example, that the Roman Empire rested upon the achievements of its road builders as much as on its concept of law; that the expansion of

Europe in the 16th century depended upon the existence of new means of crossing oceans as much as upon the will to do so. Another outstanding feature of the book is its awesome comprehensiveness; everything from basket weaving to wireless telegraphy has been given careful coverage.

As a “short” history, the book has one predictable shortcoming. Derry and Williams, in their efforts to be concise, have sometimes been too sketchy. Certain technological processes are described in such broad terms that the reader who doesn't already understand them is mystified.

All in all, however, the book provides a fascinating and readable account of the subject for the general reader. A variety of excellent line drawings illustrating technological processes considerably enhances the pages of the text.

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The Tax Exemption of Cooperatives. Robert T. Patterson. 140 pp. New York: University Publishers. \$5.00.

- In this book, a revised edition of a volume first published in 1958, Patterson states that the greatest injustice of the present tax setup is the competitive advantage given to cooperatives over corporations.

In reviewing the background and history of the cooperative movement, the author points out that many of the early cooperatives had to compete with established firms that had great financial strength. Thus, it seemed desirable for government to protect these fledgling business enterprises by exempting them from the corporation income tax. When they were small and the corporation income tax was low, this privilege was not very important. But as cooperatives grew in size and as the corporation tax increased tremendously, the tax privilege gave cooperatives a distinct advantage over their fully taxed competitors.

Patterson argues that the time has come to remove this advantage. He maintains it has given some cooperatives the power to destroy or absorb their taxed competitors. He also feels that it prevents the best use of the nation's resources and points out that it represents a considerable loss of revenue to the federal government. Moreover, he fears that the present tax exemption enjoyed by cooperatives “could conceivably be an opening wedge for some form of collectivism” in our society.

This last statement seems a bit far-fetched in a book which is basically a carefully argued, well documented study of a problem in special privilege.



THE DOMESTIC ECONOMY—American railroads have been chronic invalids for so long their troubles seldom receive the attention a healthier industry commands when it suffers a minor setback. What prophecies of doom would have resounded if another American industry had lost over 800 jobs a week during the 1950s, seen part of its business (passenger travel) fall from 65 billion miles in 1946 to 21 billion in 1960, and another part (freight carloadings) decline in the same period from 41.3 million to 30.5 million. In hard dollars and cents, railroads have lost money on passenger travel ever since 1946 and their 1959 return on investment was only 2.72%.

Yet the public interest is greater in the railroads than in most other industries. They were the first business put under federal regulation. The American railroad plant represents a net investment of \$27.5 billion (mostly in old-fashioned dollars) and is especially vital in wartime—World War II saw rail freight traffic double and rail passenger traffic quadruple.

But their troubles are legion. Air, highway and water transportation are winning ever-increasing shares of the transportation business. Many states and local communities tax the railroads at 100% of value while other real property is assessed at much less. The state and federal governments subsidize their competitors through highway building programs, airports, rivers and harbors bills, and other sometimes necessary and sometimes pork-barrel legislation. Federal regulations set their rates and prevent them from following many normal business practices, such as diversification, that their competitors usually can engage in to their hearts content.

What is to be done? The railroads themselves have attempted to meet the problem through modernization. Over \$11 billion was invested in new facilities during the 1950s, with diesel engines and new passenger accommodations being the best known of these changes.

The railroads are now investigating a new high-speed land vehicle that could challenge the airplane in intercity passenger transportation—the Levacar.

The Levacar, a wheel-less, jet-propelled vehicle now being developed by the Ford Motor Co., would ride on a thin strip of air a fraction of an inch above the rails and could obtain safe speeds of from 150 to 500 miles an hour. But the railroads maintain that these changes cannot be enough while they remain subject to present regulations and tax discriminations.

Present regulations date from a time when railroads were a virtual monopoly. Few today share the fear of the railroads that led to the first federal regulatory agency—the Interstate Commerce Commission—in 1887. The question now being asked is whether the railroads, once a natural, and, indeed, menacing monopoly, have not been changed by their highway and air rivals into just another competitive business.

In 1960 the Commerce Department recommended that subsidies and tax favoritism for other means of transportation be dropped, that railroads be permitted greater freedom in setting rates and in diversification, and that the long-term objective be to deregulate transportation. Those who do not share this objective have urged that railroads and their competitors be at least put under the same regulatory and tax system. Many groups have suggested that Congress forbid state and local governments from overtaxing the railroads as undue interference with interstate commerce.

But whatever solution is finally chosen, railroads belong as much in the area of political discussion as do Laos or disarmament; indeed, they belong there more since Congress and the individual citizen can do more about them.

bank
merger
curb

ECONOMIC NEWS NOTES—The Comptroller of the Currency has been instructed by Secretary of the Treasury Dillon not to approve any bank mergers to which the Justice Department objects.

The order represents an agreement between the Treasury and Justice Departments not to approve bank mergers which may tend to lessen competition until the courts decide the outcome of the 3 suits which the government recently filed against banks in Philadelphia, Milwaukee and Lexington, Ky.

These mergers had already been approved by the Comptroller of the Currency when the Justice Department stepped in.

Under the federal bank merger statute passed last year, the Comptroller has the final say in mergers involving national banks. But the Justice Department is required to advise him on the competitive aspects of each situation—although he is not obliged to follow their advice. While the Comptroller is nominally independent, however, he is subject to policy direction from the Secretary of the Treasury.

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SBA
cuts
interest
rates

The Small Business Administration has announced that it will offer loans at a cut-rate interest charge of 4% to small businessmen, and state and local development companies in areas designated by the Labor Department as having a "substantial labor surplus."

The agency's normal interest charge is 5 1/2%. Areas of "substantial labor surplus" are those with an unemployment rate exceeding 6% of the labor force. Two-thirds of the country's 150 major industrial areas are now on the list.

The Small Business Administration is not in competition with private banks since it only makes loans that banks are not willing to undertake. In many instances, however, the SBA makes joint loans in conjunction with private lending institutions. About 2/3 of the agency's existing loans are such joint ventures.

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More
powers
for
FTC?

James M. Landis, President Kennedy's special adviser on the regulatory agencies, has proposed that the Federal Trade Commission be given injunctive power to halt deceptive advertising.

Under the Landis proposal, the FTC would be able to use this power only when a "good showing" of illegality in advertising and merchandising methods could be demonstrated. Under present regulations, abuses may continue for 3 or 4 years while the Commission takes testimony and reaches a decision.

The FTC now has the kind of injunctive power recommended by Mr. Landis in cases of false advertising or impurities in food, drugs and cosmetics.

Even if the Administration should back the Landis proposals, they would have to pass Congress, where there is strong opposition from many business groups to any extension of the powers of the Federal Trade Commission.

This opposition is even more vehement now that Paul Rand Dixon, former counsel to Sen. Kefauver's Senate Antitrust and Monopoly Subcommittee, is Chairman of the FTC. Dixon made many enemies during last year's investigation of drug prices.